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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

JOHN G. ORDWAY, JR. and MARGARET M. ORDWAY,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the rule of *Jewett* v. *Commissioner*, 455 U.S. 305 (1982), specifying when the disclaimer of an interest is subject to gift tax, was wrongly and unconstitutionally extended by the court of appeals to the disclaimer of an interest created prior to the legislation authorizing the tax?

2. Whether a nontaxable transfer made prior to enactment of the Gift Tax Act can constitute a "taxable transfer" necessary for imposition of gift tax under Treasury Regulation § 25.2511-1(c)?

3. Whether the court of appeals wrongly applied this Court's decision in *Jewett* retroactively to Petitioners on grounds that nonretroactivity is an "affirmative defense" that Petitioners, *plaintiffs* in the action, had "waived," where:

- Petitioners had argued that the Government could not constitutionally apply *Jewett* retroactively to them;
- Retroactive application of *Jewett* unfairly and unconstitutionally caused to be taxed a transfer that was nontaxable when made; and
- Decisions of this Court and sister circuit courts of appeals make clear that an appellate court always has discretion to determine and apply the correct law to avoid substantial injustice?

PARTIES AND RULE 29.1 STATEMENT

The parties to the proceedings below were Petitioners, John G. Ordway, Jr. and Margaret M. Ordway, and Respondent, the United States of America.

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PETITION FOR WRIT OF CERTIORARI

Petitioners, John G. Ordway, Jr. and Margaret M. Ordway, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Eleventh Circuit is reported at 908 F.2d 890 (11th Cir. 1990) and is reprinted as Appendix A, *infra*, 1a-14a. Rehearing was denied without opinion. App., *infra*, 27a.

The Memorandum Decision of the United States District Court for the Southern District of Florida is reported at 89-1 U.S.T.C. (CCH) ¶ 13,802 (S.D. Fla. 1989). It is reprinted as Appendix B, *infra*, 15a-24a.

JURISDICTION

The United States Court of Appeals for the Eleventh Circuit entered its judgment on August 10, 1990. App., *infra*, 1a. A Petition for Rehearing and Suggestion of Rehearing In Banc was denied by Order entered on November 1, 1990. App., *infra*, 27a. On January 9, 1991, Justice Kennedy upon application of Petitioners ordered that the time for filing a Petition for Writ of Certiorari in this case be extended to and including March 27, 1991.

The jurisdiction of this Court to review the judgment of the Eleventh Circuit is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION, STATUTES AND REGULATIONS

The Due Process Clause of the Fifth Amendment to the United States Constitution; Internal Revenue Code (26 U.S.C.) §§ 2501(a), 2502(a) and (b), 2511(a); Revenue Act of 1932, § 501(b), 42 Stat. 169 (1932); Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009 (e)(2), 90 Stat. 1896 (1976); Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 426(b), 95 Stat. 318 (1981); Treasury Regulations (26 C.F.R.) §§ 25.2511-1 (a), 25.2511-1(c)(1958), 25.2511-1(c)(1986), 25.2511-1 (g), 25.2518-1(a)(1), 25.2518-2(c)(3), and 25.2518-2 (c)(5) *ex.* 1 are set forth at Appendix E, *infra*, 29a-37a.

STATEMENT OF THE CASE

A. Statement of Facts

On January 16, 1917, over fifteen years before the enactment of the federal gift tax laws in the Revenue Act of 1932 (the "Gift Tax Act" or "Act"), Lucius P. Ordway ("Lucius") created an inter vivos irrevocable trust for the benefit of his wife and issue (the "Trust").

Under the terms of the Trust, income was to be paid to Lucius' wife and children for their lives, and upon the death of the survivor of them, the corpus of the Trust was to be distributed to Lucius' grandchildren *per capita*, with the share of any then deceased grandchild to be distributed to the grandchild's issue *per stirpes*. App., *infra*, 2a.

Petitioner John G. Ordway, Jr., a grandchild of Lucius, was born in 1922 and upon his birth became a contingent remainderman of the Trust. That interest vested on June 27, 1979, upon the death of Lucius' last surviving child, at which time Petitioner became entitled to receive his share of the corpus of the Trust. Rather than accepting the transfer, however, Petitioner timely filed a partial disclaimer of the interest ("Disclaimer")[1] with a state district court in Minnesota pursuant to Minn. Stat. § 501.211.[2] Under Minnesota law, the effect of the Disclaimer was that the disclaimed interest was treated as if it had never passed to Petitioner, and it passed instead from the Trust directly to the beneficiaries who would take under the trust instrument if Petitioner were not then living—in this case, Petitioner's children. Minn. Stat. § 501.211, subd. 5. Petitioner did not through his Disclaimer acquire or exercise a power to direct to whom the interest would be distributed in his stead, but remained bound to the terms of distribution set forth in the trust instrument. App., *infra*, 2a.

At the time of the Disclaimer, it was settled as a matter of federal law in the Eighth Circuit, where Petitioners resided, that a disclaimer would be free from gift tax if made within a "reasonable time" following the vesting of a contingent interest. *See Keinath* v.

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[1] A "disclaimer" is the "refusal, or rejection of an estate, . . . the disavowal, denial, or renunciation of an interest . . . ." Black's Law Dictionary 417 (5th ed. 1979). A "partial" disclaimer operates only with respect to a stated portion of the interest.

[2] The Trust was organized under and governed by Minnesota law.

Commissioner, 480 F.2d 57 (8th Cir. 1973). Treasury Regulation § 25.2511-1(c) (1958) (the "Regulation"), established the federal "reasonable time" standard, and provided that it was to run from the time of the "transfer" disclaimed.[3] The court in *Keinath*, applying the "prevailing common law," held that the "transfer" in question was the transfer that occurred when an interest vested, *e.g.*, upon the death of the last life income beneficiary. On April 14, 1978, the Internal Revenue Service ("IRS") issued Technical Advice Memorandum 7829008 (the "T.A.M."), stating IRS policy that *Keinath* would be followed with respect to taxpayers residing in the Eighth Circuit. Following *Keinath* and the T.A.M., Petitioner timely filed his Disclaimer upon the death of the last of Lucius' children in 1979 and disclosed it on his third quarter 1979 federal gift tax return. In accordance with governing law, he did not report it as a taxable transfer. App., *infra*, 3a.

On December 9, 1980, the United States Court of Appeals for the Ninth Circuit decided *Jewett* v. *Commissioner*, 638 F.2d 93 (9th Cir. 1980), in conflict with *Keinath*. Less than a month later, a petition for certiorari was filed in *Jewett*. Pending this Court's decision in that case, the IRS informed Petitioner that his third quarter 1979 federal gift tax return was under audit. App., *infra*, 3a.

On February 23, 1982, this Court issued its opinion in *Jewett* v. *Commissioner*, 455 U.S. 305 (1982) (6-3 decision), which overruled the prior rule of *Keinath*. Unlike this case, *Jewett* involved the disclaimer of an interest passing under a trust established after enact-

[3] Treasury Regulation § 25.2511-1(c) provided, *inter alia*, that "a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable [sic] and effective under the local law." 26 C.F.R. 25.2511-1(c) (1958). *See* App., *infra*, 31a-32a.

ment of the Gift Tax Act. The Court held that the reasonable time period for a disclaimer under the Regulation begins to run not from the time when the interest vests and the taxpayer becomes entitled to receive a distribution, but from the time of the original transfer that creates the taxpayer's contingent interest.

If applied retroactively to Petitioner, and extended to a transfer under a pre-Gift Tax Act trust,[4] the Court's 1982 decision in *Jewett* would require that Petitioner have filed his partial disclaimer decades earlier in order for it to be free from gift tax under the Regulation.[5]

The IRS so applied *Jewett* and proposed a deficiency against Petitioners.[6] In response, Petitioners filed amended gift tax returns for the third quarter of 1979 and the first quarter of 1980 reflecting the Disclaimer as a taxable transfer, and paid the additional federal gift taxes due together with interest thereon. Thereafter, they timely filed claims for refund of the additional gift taxes and interest paid. The IRS denied the claims. App., *infra*, 3a-4a.

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[4] While precise figures are unavailable, Petitioners believe that assets held in pre-Act trusts total tens of billions of dollars, if not more. There are other cases in various circuits already pending on the issue presented in this case. *See, e.g., Irvine* v. *United States*, 89-2 U.S.T.C. (CCH) ¶ 13,818 (D. Minn. 1989), *appeal docketed*, No. 89-5616 MN (8th Cir. filed December 21, 1989); *Johnson* v. *United States*, No. 89-8192-CIV NESBITT (S.D. Fla. filed April 27, 1989).

[5] It is not clear when *Jewett* would have required Petitioner to disclaim—following his birth in 1922, passage of the gift tax in 1932, his learning of the interest in 1941, his reaching the age of 21 in 1943, or promulgation of the Regulation in 1958 that was construed in *Jewett* in 1982.

[6] Petitioner Margaret M. Ordway is a party hereto by reason of her consent to have the gifts made by her husband during the third quarter 1979 and first quarter 1980 be treated as having been made one-half by each spouse. 26 U.S.C. § 2513.

B. Proceedings Below

On March 16, 1987, Petitioners filed a complaint in the United States District Court for the Southern District of Florida, where they then resided, seeking a refund of the federal gift taxes and interest paid to the Commissioner of Internal Revenue for the calendar quarters ending September 30, 1979 and March 31, 1980. On cross-motions for summary judgment, Petitioners argued that neither the Regulation nor *Jewett* applied to them because the Trust was created prior to passage of the Gift Tax Act.[7] The date of formation of the Trust is essential, Petitioners argued, because the Gift Tax Act by its own terms applies only to transfers made after its enactment date—a limitation compelled by this Court having twice struck down portions of a predecessor statute as imposing an unconstitutional retroactive excise tax. *See Blodgett* v. *Holden*, 275 U.S. 142, 147 (1927); *Untermyer* v. *Anderson*, 276 U.S. 440, 445 (1928). Petitioners reasoned that this Court, Congress, and the IRS, in considering whether application of a new gift tax rule to a disclaimer was retroactive, always had used as a reference the date when the interest disclaimed was created. Petitioners concluded that by deviating in their case from this consistent pattern and more than sixty years of settled jurisprudence, the IRS had imposed an unconstitutionally retroactive gift tax. App., *infra*, 21a.

Petitioners also argued that the Commissioner's decision was contrary to the plain language of the Regula-

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[7] Petitioners do not maintain that disclaimers of pre-Act interests can never be subject to tax. Rather, consistent with the constitutional and congressional prohibition against retroactive application of the gift tax, Petitioners maintain that only the rules existent at the time his interest was created can properly govern the taxability of the subsequent disclaimer of that interest. Thus, with respect to Petitioner's interest, which was created by a transfer prior to enactment of the Gift Tax Act, compliance with state law is all that is required for the disclaimer not to constitute a transfer subject to tax.

tion, which limits imposition of the gift tax to disclaimers of interests created by "taxable transfers." [8] Because the interest disclaimed was created by the *non*taxable, 1917 transfer of assets to the Trust, Petitioners contended that the textual requirements of the Regulation simply were not met and that the tax could not be imposed.

The Government responded that the Regulation governed the Disclaimer, and that *Jewett* should be extended to include disclaimers of pre-Gift Tax Act transfers exempt from the imposition of the gift tax. Contrary to the position it took before this Court in *Jewett*, the Government argued that the constitutional prohibition against retroactivity is to be judged solely with reference to the date of the disclaimer, irrespective of the date when the transfer creating the interest disclaimed had been made. The Government also argued that the phrase "taxable transfer" in the amended Regulation merely refers to transfers that are "completed" for gift tax purposes even if, like the transfer that created the Trust, they are constitutionally nontaxable.

On March 13, 1989, the District Court granted Petitioners' motion for summary judgment and denied Respondent's motion for summary judgment. On May 16, 1989, the District Court entered final judgment against Respondent and in favor of Petitioners in the amount of $5,370,336.30, together with interest from May 9, 1989, as provided by law. App., *infra*, 25a-26a.

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[8] The Regulation was amended in 1986, T.D. 8095, 1986-2 C.B. 160, to conform to regulations promulgated under the 1976 amendments to the Code, in part to add the word "taxable" to the Regulation's requirement. The Government does not dispute the claimed applicability of the amended Regulation to Petitioner's disclaimer, and agrees that the amendment in pertinent part did not alter the Regulation's meaning as relevant here. A certain amount of retroactivity in the operation of Treasury Regulations is permitted by statute. *See* 26 U.S.C. § 7805(b).

Respondent appealed. On August 10, 1990, a divided panel of the United States Court of Appeals for the Eleventh Circuit reversed the District Court's grant of summary judgment in favor of Petitioners. Acknowledging that Lucius' 1917 transfer "was not subject to the gift tax," App., *infra*, 9a, and "was not taxable in the sense that it was made before the gift tax existed," *id.*, the majority nevertheless concluded that Lucius' 1917 transfer was a "taxable transfer" within the meaning of the Regulation, and that the Regulation applies not only to Petitioner's disclaimer but to all disclaimers of any interests created in pre-Act transfers or other nontaxable events. Application of this Court's prior decision in *Jewett* thus was held to be dispositive of the case. The court of appeals did not address the substantial authority cited by Petitioners that the concept of retroactivity in application of the gift tax to disclaimers is to be measured with reference to the date of the transfer creating the interest disclaimed, not the date of the disclaimer.

Senior Circuit Judge Floyd R. Gibson of the United States Court of Appeals for the Eighth Circuit, sitting by designation, dissented. Judge Gibson believed that the retroactive application of this Court's 1982 decision in *Jewett* to Petitioner's 1979 Disclaimer produced a fundamentally unfair result. He concluded Petitioner's reliance upon the contrary and settled governing law at the time the Disclaimer was made was reasonable, and that to penalize Petitioner for failing to disclaim earlier, when the law gave him no notice of his need to do so, could not be countenanced. The majority, without reference to binding precedent, responded by mischaracterizing the nonretroactive application of *Jewett* as an "affirmative defense" that Petitioners, plaintiffs in the case, had "waived." App., *infra*, 11a. Thus finding its hands tied by a procedural bond, the majority did not address the retroactivity question or the fairness of applying *Jewett*

to Petitioner's earlier conduct. The case was remanded to the District Court for a determination of certain valuation issues.

Petitioners' Suggestion of Rehearing In Banc and Petition for Rehearing was denied on November 1, 1990. A case presenting essentially identical claims of Petitioner's sister, Sally Ordway Irvine, was decided in the taxpayer's favor by the United States District Court for the District of Minnesota in *Irvine* v. *United States*, 89-2 U.S.T.C. (CCH) ¶ 13,818 (D. Minn. Sept. 18, 1989). The IRS appealed. The case was argued before the United States Court of Appeals for the Eighth Circuit on September 10, 1990 and presently is awaiting decision. *See Irvine* v. *United States, appeal docketed*, No. 89-5616 MN (8th Cir. filed December 21, 1989).

REASONS FOR GRANTING THE WRIT

I. APPLICATION OF *JEWETT* v. *COMMISSIONER* TO THIS CASE UNCONSTITUTIONALLY IMPOSES A RETROACTIVE GIFT TAX AND UPSETS SIXTY YEARS OF SETTLED JUDICIAL, LEGISLATIVE, AND EXECUTIVE UNDERSTANDING AS TO THE CONSTITUTIONAL LIMITS ON THE POWER TO TAX

For more than sixty years, a fundamental constitutional limitation on Congress' power to impose gift and other excise taxes has been the requirement that such taxes not be imposed retroactively. This limitation applies to the imposition of the gift tax on disclaimers, and this Court, Congress, and, in the past, the IRS, have consistently interpreted it to mean that federal legislation imposing a gift tax may not apply to interests already in existence at the time of the legislation. The decision of the majority breaks with this precedent and authorizes what is a substantial and clearly unconstitutional tax to be levied against Petitioners. The decision, moreover, undermines the constitutional basis on which gift tax

legislation for decades has been based—legislation involving not only disclaimers but matters of trust administration and lifetime transfers. This case has great significance beyond its litigants, and beyond the context of pre-Gift Tax Act trusts in which the majority's departure from constitutional norms has manifested itself.

Beginning with Congress' first efforts in 1924, this Court has declared that gift taxes may not in conformity with the Due Process Clause be applied retroactively. *See Blodgett* v. *Holden*, 275 U.S. 142, 147 (1927); *Untermyer* v. *Anderson*, 276 U.S. 440, 445 (1928);[9] *cf. Lewellyn* v. *Frick*, 268 U.S. 238, 251-52 (1925) (Holmes, J.) (estate tax cannot be applied retroactively). Like all excise taxes, gift taxes must be applied only prospectively, because taxpayers have a right to know when and how they will become liable for them.[10] *Welch* v. *Henry*, 305 U.S. 134, 147-48 (1938); *Untermyer*, 276 U.S. at 445-46. Congress codified the prohibition against retroactive application as positive law with passage of the first constitutional gift tax in 1932, which specifically provides that "[t]he tax shall not apply to a transfer made on or before the date of enactment of this act [June 6, 1932]."

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[9] *Blodgett* and *Untermyer* examined the application of the first federal gift tax provisions enacted in §§ 319-324 of the Revenue Act of 1924, 43 Stat. 313-316, and held that the act was operative only from its date of enactment and only with respect to gifts thereafter made. The statute was repealed in § 1200 of the Revenue Act of 1926, 44 Stat. 125. Sections 501-532 of the Revenue Act of 1932 reinstated the gift tax for transfers made after its date of enactment. Revenue Act of 1932, § 501(b), 42 Stat. 169.

[10] At least in connection with income taxes, tax laws having some retroactive effect are not *per se* unconstitutional, but violate the Due Process Clause generally where a change is not reasonably foreseeable and effectively imposes a new tax. *See United States* v. *Darusmont*, 449 U.S. 292, 299 (1981) (per curiam). Even these criteria easily are met on the facts here. *Cf. Untermyer* v. *Anderson*. The matter in any event is not at issue. The question addressed is not whether retroactive application of the gift tax is permissible, but what retroactivity means in the disclaimer and related contexts.

Revenue Act of 1932, § 501(b), 42 Stat. 169 (1932). App., *infra*, 30a.

This constitutional and congressional proscription against retroactive application of the gift tax laws applies, of course, to the taxation of disclaimers. The question presented here is whether retroactivity is measured with reference only to the time of the disclaimer, or whether it must relate to the time of the original transfer, and therefore protect the rights and expectations of the donors, whose transfers created the interests being disclaimed, and their beneficiaries.[11] Every branch of government has spoken on this question and, until the decision of the court of appeals, was in agreement: A new gift tax must not reach back in time to alter the consequences of transfers made before its effective date.

Congress disclosed its understanding of the law unambiguously in 1976, and again in 1981, with legislation intended to make uniform the federal taxation of disclaimers. Section 2518 of the Internal Revenue Code ("Code"), allows a person to disclaim an interest without tax, *inter alia*, within nine months from the "transfer creating the interest in such person." Pub. L. No. 94-455, § 2009(b), 90 Stat. 1893 (1976). Section 2518 was made effective "with respect to transfers creating an interest in the person disclaiming made after December 31, 1976." App., *infra*, 30a. Prospective application of the change in the law, in other words, turned not on the date of the disclaimer but on the date of creation of the interest disclaimed; disclaimers of interests created prior to the change could not be subject to the change. Congress amended Section 2518 in 1981, and again reflected the same understanding of how proscribed retroactivity

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[11] The rights of the original transferor are properly before the Court as they determine the rights of Petitioners. *See Hodel* v. *Irving*, 481 U.S. 704, 711-12 (1987).

in the gift tax context must be understood.[12] *See* Pub. L. No. 97-34, § 426(b), 95 Stat. 318 (1981); App., *infra*, 31a.

This Court similarly recognized in *Jewett* v. *Commissioner* that evaluating whether taxation of a disclaimer is impermissibly retroactive does not turn simply on whether the disclaimer occurred before or after the legislation authorizing the tax. One of the taxpayer's arguments to this Court in *Jewett* was that he had a right to disclaim free of tax that the Regulation could not operate retroactively to take away. 455 U.S. at 317. This Court disagreed, observing that the *interest at issue* was created after passage of the gift tax provisions in 1932, *id.*, and hence was made with a presumption of taxability.

The IRS, with the endorsement of the court of appeals, now seeks to extend *Jewett* to pre-Gift Tax Act cases based solely on the date on which the disclaimer was made. Not only is that extension unwarranted under the facts of *Jewett*, but it also would be contrary to this Court's stated rationale.[13] That rationale should not be

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[12] The same congressional intention not to disturb transfers made before the enactment of a new gift tax has been evidenced in the context of the release of general powers of appointment, which this Court in *Jewett* recognized as similar to disclaimers. 455 U.S. at 317-18. In making such releases taxable in 1942, Congress exempted releases of general powers of appointment created before the tax was enacted, irrespective of when the release might ultimately be made. *See* Section 2514(a) of the Code. *Cf.* Treas. Reg. § 26.2601-1(b)(1)(v)(B) (1988) (exercise of limited power created before effective date of generation-skipping transfer tax not to be considered a generation-skipping transfer regardless of when made).

[13] The Court's focus in *Jewett* on the date of the creation of the interest disclaimed was consistent with the long line of this Court's cases that established the fundamental principle of nonretroactivity in the estate tax context. At issue was whether the tax constitutionally could extend to property transferred into trust by the decedent before his death, and thereupon transferred

foreign to the Government, which urged its adoption before this Court in *Jewett*. Responding to the claim that applying the 1958 Regulation to the subsequent disclaimer of a 1939 transfer was impermissibly retroactive, the United States stated:

> To begin with, Petitioner never had a right to disclaim his remainder interest free of gift tax. That tax is imposed by provisions of the Code enacted in 1932—seven years before his grandmother's death. The Regulation merely defines a narrow exception to the application of the comprehensive language of those Code provisions [citations omitted]. Thus, the Regulation did not deprive Petitioner of any preexisting right.

Brief of United States at 37-38, *Jewett* v. *Commissioner*, 455 U.S. 305 (1982) (No. 80-1614) (footnote omitted). The Government's argument in *Jewett* represents an acknowledgment by the IRS that the disclaimers of rights and interests predating passage of the Gift Tax Act should remain undisturbed by subsequently-enacted taxing statutes [14]—the principal issue dispositive of this case. The language of the Regulation is not to the contrary, nor could it be: A regulation cannot expand the reach of the statute under which it was promulgated. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 213-14 (1976). Nor should it be read to raise serious questions of constitutional application when the more straightforward interpretation avoids these issues and is consonant with congressional

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to the contingent beneficiaries. This Court recognized in a variety of factual contexts that the key event was when the property had been placed irrevocably beyond the control of the settlor, not when death or some other event caused the trust corpus to be distributed. *See, e.g., Helvering* v. *City Bank Farmers Trust Co.*, 296 U.S. 85, 89 (1935); *Helvering* v. *Helmholz*, 296 U.S. 93, 97-98 (1935); *Reinecke* v. *Northern Trust Co.*, 278 U.S. 339, 345 (1929); *Nichols* v. *Coolidge*, 274 U.S. 531, 542-43 (1927).

[14] The position of the IRS admittedly has been inconsistent. *Cf. Fuller* v. *Commissioner*, 37 T.C. 147 (1961).

intent. *See United States* v. *Clark*, 445 U.S. 23 (1980); *United States Civil Serv. Comm'n* v. *National Ass'n of Letter Carriers*, 413 U.S. 548 (1973).

Evaluating retroactivity with reference to when the interest disclaimed was created is indeed the proper approach to the constitutional inquiry. Unlike a gift, which presupposes that the donor possesses property that he or she may subsequently transfer, a disclaimer is a refusal to accept property *ab initio*. *See* A. Scott, *Trusts* § 36.1 (3d ed. 1967). Only one transfer occurs on the disclaimer of a property interest: The transfer from the original transferor to his or her designated beneficiary. While for federal gift tax purposes a disclaimer involves two events—the original transfer which creates the property interest and the act of refusing to accept that interest—and while each may under certain conditions have separate tax consequences, each nevertheless is inextricably part of that one transfer. Thus, because the disclaimed interest in all cases passes from the original transferor to the person designated by him or her, the Act's prohibition against retroactive application of the gift tax must encompass the original transfer. The consistent actions of government in enacting, construing, and enforcing gift tax provisions in the disclaimer context have, until the decision of the court of appeals in this case, correctly reflected this understanding.

The majority's decision addresses none of these constitutional, statutory, or conceptual problems, despite their having been briefed fully below. Rather, the majority appeared to view its task simply as deciding which of two regulations,[15] neither of which could apply to a

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[15] If the timeliness standard is met under Section 2518 or the Regulation, whichever is applicable in a given case, then for gift tax purposes the single transfer is considered to pass from the original transferor to his or her designated beneficiary. The majority's conclusion that satisfaction of the timeliness standard operates in a manner different under the Regulation than under Section 2518 is a gross misconstruction of the federal gift tax treatment of disclaimers. *See* App., *infra*, 7a-8a.

pre-Gift Tax Act transfer, would govern. App., *infra*, 9a. Not surprisingly, the answer to that question was unilluminating as to the genuine issues presented in this case, and was contrary to important and long-held principles of law.

In the area of disclaimers alone, the decision unfairly and unconstitutionally upsets the settled expectations of donors who no longer have the ability to reorder their affairs, and beneficiaries whose good faith and reasonable reliance upon settled law and administrative pronouncement will cost them dearly. Whole classes of trust beneficiaries whose interests were created in pre-Gift Tax Act transfers are denied the right which they possess to disclaim an interest in property free of tax consequences.[16] And the problem is not limited to the disclaimer of pre-Act interests. The position of the IRS is that Congress may amend the gift tax laws retroactively with respect to interests created at any time prior to amendment so long as the original transfer is completed by some post-amendment event. Recognition by Congress of such a previously forbidden power would have terribly disruptive effects, injecting unpredictability into major elements of financial management and estate planning where the need for certainty is great.

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[16] Throughout this litigation Petitioner has faced the false and unfair claim that he sat on his rights and waited too long to disclaim. The punishment sought to be levied against him for his supposedly derelict conduct is the sacrifice of his statutory and constitutional rights to be free from retroactive gift taxation. Petitioner's conduct, however, was fully in accord with law specifically made applicable to him by the federal courts and the IRS. And it was fully in accord with Congress' uniform practice of changing the rules regarding gift taxes only prospectively. *See supra* at 11-12 & n.12. The federal regulations regarding post-Gift Tax Act trusts did not apply to Petitioner, and how long he waited before disclaiming, so long as he was in compliance with the state law, is of no moment.

II. THE COURT OF APPEALS' CONSTRUCTION OF THE APPLICABLE TREASURY REGULATIONS IS CONTRARY TO THEIR PLAIN LANGUAGE AND WILL SUBVERT THE GOAL OF THEIR IMPLEMENTING STATUTES

A. The Majority's Opinion Construes the Regulation Contrary to Its Authorizing Statute and Its Own Plain Language, and Upsets More Than Thirty Years of Consistent Administrative Enforcement and Public Reliance Thereon

Review is warranted for the further reason that the majority, wholly apart from its constitutional and statutory errors, has construed the Regulation contrary to its plain language and in a manner that will have an unforeseen and unwelcome impact in a variety of important areas of application of the gift tax. The Regulation, as amended, permits imposition of the gift tax only on disclaimers of interests created by "taxable transfers"—a key term in applying the gift tax laws consistently and in accordance with congressional intent. The transfer giving rise to the interest disclaimed by Petitioner in this case was *nontaxable*, having been made by Lucius Ordway fifteen years prior to enactment of the Gift Tax Act. The majority nonetheless finds the transfer to have been a "taxable transfer," concluding that the Regulation requires only that there be "any transaction in which an interest in property is gratuitously passed or conferred upon another," "regardless of whether a gift tax is imposed on the completed gift." App., *infra*, 9a (quoting Treas. Reg. §§ 25.2511-1(c)(1) and 25.2518-2(c)(3)).

That a "taxable transfer" means a transfer subject to tax would appear self-evident and unambiguous. The construction is compelled by the statutory language and is binding on the IRS. *See Chevron USA, Inc.* v. *National Resources Defense Council*, 467 U.S. 837 (1984). Section

2501(a) of the Code, entitled "Taxable Transfers," [17] makes subject to the gift tax in each calendar year only the "transfer of property by gift *during* such calendar year." App., *infra*, 29a (emphasis added). Section 2502, to which Section 2501 refers, limits "calendar year" to periods of time after enactment of the gift tax on June 6, 1932. App., *infra*, 29a-30a. Transfers of property prior to that date do not fall within the statutory definition and thus are not "taxable transfers." To the same end is Section 2511, which defines the "transfers" to which the gift tax shall apply. The class of transfers so defined is expressly made subject "to the limitations contained in this chapter"—including, of course, the 1932 frontier before which the statute, constitutionally and by its own terms, cannot extend.[18] *See* App., *infra*, 30a.

The majority's errors in reaching a contrary conclusion are patent. First, it relies upon regulations promulgated under Section 2518, which was added in 1976 and, like all congressional changes in the disclaimer context, was expressly made applicable only to interests created after its effective date. *See* App., *infra*, 30a. Regulations promulgated pursuant to Section 2518 hardly can be taken as a reasonable basis to mischaracterize a pre-Gift Tax Act transfer as "taxable." Second, the majority, in quoting regulations under Section 2511, commits the sin of failing to complete the quotation. Treasury Regulation § 25.2511-1(c)(1) indeed refers to "any transaction in which an interest in property is gratuitously passed or conferred upon another," but does not, as the majority states, equate that phrase with a trans-

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[17] Section 2501(a) was added to the Code in 1954. Act of August 16, 1954, c. 736, 68A Stat. 403. The title was added in 1966 following amendments not relevant here. Pub. L. 89-809, Title I, § 109(a), 80 Stat. 1574 (1966).

[18] Applicable Treasury Regulations also are in accord. The first two sentences of § 25.2511-1(a) (promulgated in 1958), unambiguously equate a "taxable transfer" with a "transfer" to which the gift tax applies. *See* App., *infra*, 31a.

fer that can be used for measuring time. *See* App., *infra*, 9a. Rather, the regulation concludes that such a transaction "constitutes a gift subject to tax." *See* App., *infra*, 31a-32a. No transfer occurring prior to passage of the Gift Tax Act can be a "gift subject to tax," and efforts to construe the Regulation to apply to pre-Act transfers must be in vain.

The majority further errs in assuming that Lucius Ordway's 1917 transfer was a "completed gift for Federal gift tax purposes." *See* App., *infra*, 9a (quoting Treas. Reg. § 25.2518-2(c)(3)). There was no gift tax in 1917, and the transfer simply could not so qualify. The majority apparently forgave this jurisdictional defect by noting that the regulation attaches "regardless of whether a gift tax is imposed on the completed gift," *id.*, and assuming that even *nontaxable* transfers could thus qualify. The majority's first error is to fail to recognize that even the clause it relies upon does not read out of the regulation the requirement that there had to be a "completed gift for Federal gift tax purposes"—which there could not have been here. Second, the majority overlooks the obvious and expressly stated purpose of the clause to ensure that all taxable transfers trigger the disclaiming period, even if no gift tax payment needs to be made as a result.[19] *See* App., *infra*, 36a.

What transfers are "taxable" and what are nontaxable under § 25.2511-1 has been clearly understood and uniformly applied for more than thirty years. The majority's opinion thus sanctions an impermissible "sudden and unwarranted volte-face from these consistent administrative" rules that have been relied upon and strictly enforced for years. *Fribourg Navigation Co.* v. *Commissioner*, 383 U.S. 272, 279 (1966). It injects,

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[19] "Taxable transfers" of $10,000 annually, for example, may be made without payment of the gift tax. *See* Section 2503(b). Application of that exclusion should not affect whether and when a disclaimer of the interest must be made in order to be nontaxable.

without any reasonable or discernible basis for doing so, a disruptive and uncertain element over what, in the future, will or will not be considered a taxable transfer under Section 2511, leaving to question how, and in what manner, many taxpayers are to handle their affairs in transferring property to their loved ones.

B. By Refusing to Limit Taxation of Disclaimers to Interests Created in "Taxable" Transfers, the Majority Decision Will Permit Taxpayers to Avoid Taxation of Gifts, Bequests, and Generation-Skipping Transfers

The majority's failure to limit the Regulation to disclaimers of "taxable" transfers has implications far beyond this case. Permitting any gratuitous transfer to trigger the federal disclaimer window, whether or not that transfer "constitutes a gift subject to tax," eviscerates the statutory scheme under Section 2518 of the Code for determining the taxability of disclaimers. It invites taxpayer abuse, destroys uniformity in the application of disclaimer rules—Congress' primary goal in enacting Section 2518—and has the potential for permitting taxpayers to overrule the *Jewett* decision by shrewd planning.

The majority's decision to permit nontaxable transfers to commence the period for disclaiming an interest was never intended by Congress. Allowing the majority's decision to stand means that extraneous and irrelevant events now will control the question of when a disclaimer may be made without payment of the gift tax—an area of the law thought to be made uniform and deemed settled after *Jewett* and enactment of Section 2518. *See* H.R. Rep. No. 1380, 94th Cong., 2d Sess., *reprinted in* 1976 U.S. Code Cong. & Admin. News 3356, 3419-22.

For example, the exercise of a nongeneral power of appointment or a trustee's distribution made pursuant to a reasonably fixed or ascertainable standard is not a transfer subject to the gift tax. *See* Section 2514; Treas.

Reg. § 25.2511-1(g). Nevertheless, each constitutes a "transaction in which an interest in property is gratuitously passed or conferred upon another" and under the majority's opinion would constitute a taxable transfer commencing a measuring period. As such, and because under Treasury Regulation § 25.2518-2(c)(3) the nine-month disclaimer period is "to be determined with reference to the taxable transfer creating the interest in the disclaimant," serial exercises or trust distributions of this type to beneficiaries with full and prior knowledge of their interests necessarily would each be considered separate "taxable transfers," and each would trigger separate nine-month disclaimer periods. Such a result, permitting a tax free disclaimer to be made long after the underlying taxable transfer has occurred, clearly was not intended by Congress or the IRS. But it is compelled by the majority's refusal to abide by the congressionally-directed taxable transfer standard appearing on the face of the statute and the applicable Treasury Regulations.

Indeed, the rationale of the majority will permit taxpayers to defeat not only the gift tax but the generation-skipping transfer tax as well. Consider, for example, a trust created by a great grandparent for the benefit of his child, grandchild and great grandchild, which provides that a trustee may designate if and how much corpus is to be distributed to each beneficiary. Twenty-five years after the trust is created, the trustee designates the child to receive a portion of the corpus. Within nine months the child then disclaims, and the interest passes by operation of the trust to his or her child. The grandchild also then disclaims within nine months of his parent's disclaimer, and the designated portion of the corpus ultimately passes to the grandchild's child. Under the majority's reasoning, the disclaimer by the child and grandchild would each be nontaxable. The result is that the great grandfather, through the disclaimers of his child and grandchild, has effectively directed the transfer of

a property interest to his great grandchild free of any further gift or estate tax and free of any generation-skipping transfer tax.[20] *See* Section 2601 *et seq.* *But see* App., *infra*, 35a-37a (Treas. Reg. §§ 25.2518-2 (c) (3), 25.2518-2(c) (5) *ex.* 1).

The majority did not understand the statutory and regulatory scheme it was construing, and could not comprehend the consequences of its errors. Those consequences will not long remain hidden from the tax and estate planning bars, however, and review by this Court is necessary to foreclose efforts at tax avoidance and restore to the taxation of disclaimers the fair and uniform application that Congress sought to achieve.

III. THE MAJORITY WRONGLY AND PREJUDICIALLY APPLIED *JEWETT* v. *COMMISSIONER* TO PETITIONERS

A. The Majority Wrongly Concluded That Petitioners Had "Waived" the "Affirmative Defense" of Nonretroactive Application of *Jewett*

The majority of the court of appeals refused to question whether *Jewett* should be applied retroactively to Petitioners because the court deemed nonretroactivity to be an "affirmative defense" that Petitioners had "waived." App., *infra*, 11a. How Petitioners—the *plaintiffs* below—could be punished for failing to raise an affirmative defense defies comprehension. More to the point, no such waiver occurred, and the majority improperly abdicated its obligation to determine and apply the correct law to the case.

Petitioners' central argument throughout this litigation has been that *Jewett* cannot apply to them because to do

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[20] The IRS may wish somehow to limit the majority's opinion in order to avoid so clearly improper a result. No such limitation appears in the opinion itself, however, and it would be inconsistent with the majority's expressly stated rationale.

so would impose an unconstitutionally retroactive tax. On their theory, the retroactivity of *Jewett* itself is not at issue, and is not an element of their cause of action required separately to have been pleaded and proved. The issue of retroactivity of *Jewett* can only fairly be considered subsumed within the claims and arguments relating to retroactivity that Petitioners have been making since this case began. To say that one issue is raised and the other is not involves distinctions that serve no purpose. *Cf. Braniff Airways* v. *Nebraska State Bd.*, 347 U.S. 590 (1954). The majority cited no precedent for imposing on a plaintiff the duty to allege every conceivable argument in the alternative,[21] and for it so to hold provides a perverse obligation to pack briefs to the bursting point with what in most cases would be diversionary minutiae.

The majority's substantive holding is that it had no discretion whatsoever to consider that *Jewett* should not be applied retroactively to Petitioners, notwithstanding that such application, as the dissent correctly observed, would produce palpably unacceptable consequences. This is plainly wrong. It is settled that courts have the power to address *sua sponte* the question whether a decision of this Court should be accorded retroactive effect. Such consideration indeed is "far from novel". *See Teague* v. *Lane*, 489 U.S. 288, 300 (1989) (plurality opinion); *Allen* v. *Hardy*, 478 U.S. 255, 259-60 (1986) (per curiam) and *id.* at 261-62 (Marshall, J., dissenting) (noting failure of parties to raise nonretroactivity below); *Shea* v. *Louisiana*, 470 U.S. 51, 55-56 n.3 (1985); *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969). The Seventh Circuit, in direct conflict with the decision at bar, similarly has concluded that there are various non-

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[21] Every case cited by the majority—most of which indeed were contrary to the majority's holding on the question of waiver—involved a defendant who failed to raise nonretroactivity as a defense. *See* App., *infra*, 11a-12a. Fed. R. Civ. P. 8(c) and 12(b) and (h) impose obligations on defendants in this regard that might account for any asymmetry.

jurisdictional principles—specifically including nonretroactivity—that a court is entitled to raise on its own initiative where the ends of justice so require. *See Thomas* v. *Indiana*, 910 F.2d 1413, 1415-16 (7th Cir. 1990) (Posner, J.); *Hanrahan* v. *Greer*, 896 F.2d 241, 245 (7th Cir. 1990) (Easterbrook, J.). So, too, has been the conclusion of the Third Circuit. *See Weaver* v. *Bowers*, 657 F.2d 1356, 1362 (3d Cir. 1981), *cert. denied*, 455 U.S. 942 (1982). *See generally Singleton* v. *Wulff*, 428 U.S. 106, 121 (1976); *Hormel* v. *Helvering*, 312 U.S. 552, 556-57 (1941).

Any attorney who has practiced in the federal courts knows the frequency with which courts resolve cases on lines different from those suggested by the parties, or request supplemental briefing on a point raised by the court *sua sponte*. *See, e.g.*, 11th Cir. R. 28-4 (Supplemental Briefing by Order of Court). By believing wrongly that its hands were tied, the majority departed from these sound practices and deviated from settled law in an inexcusable way that warrants review by this Court.[22]

B. The Court of Appeals' Failure to Consider the Retroactivity of *Jewett* Visited Upon Petitioner a Fundamental and Constitutionally-Prohibited Injustice

There can be little doubt that the effect of the majority's refusal to consider the fundamental unfairness of a retroactive application of *Jewett* indeed is to visit that injustice upon Petitioner. The facts supporting this con-

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[22] Although significant, the error made by the court of appeals majority is narrow, apparent on the face of the decision, and turns upon no disputed factual issues. To the extent the issue of waiver need even be reached, Petitioners respectfully suggest that summary disposition pursuant to Sup. Ct. R. 16.1 may be appropriate to remand this case to the court of appeals for further consideration as to the retroactive application of *Jewett* v. *Commissioner* under the rule of *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), discussed *infra*.

clusion, as outlined by Judge Gibson in his dissent, are undisputed. At the time Petitioner filed his disclaimer, and at all relevant times prior thereto, the rule in the Eighth Circuit was that the disclaimer of an interest was effective for federal gift tax purposes if made within a reasonable time after the interest became vested, such as in the case of Petitioner, upon the death of the last surviving life tenant. *Keinath* v. *Commissioner*, 480 F.2d 57, 64 (8th Cir. 1973) (applying "the prevailing common law"). The Commissioner of Internal Revenue did not appeal *Keinath* and, notwithstanding his continuing opposition to the rule, expressly acknowledged in the T.A.M. that it would be followed with respect to taxpayers residing in the Eighth Circuit. *Accord Cottrell* v. *Commissioner*, 628 F.2d 1127, 1131 (8th Cir. 1980) (en banc). The majority concedes, App., *infra*, 3a n.2, that Petitioner relied upon *Keinath* (and the preexisting common law rule) at the time of his disclaimer, yet holds him responsible for predicting its demise. The consequence of the majority's decision, Judge Gibson concluded, is that "[Petitioner] will suffer severe tax consequences for failing to do something at a time when the law provided him with no notice that he needed to act." App., *infra*, 13a; *see also Jewett*, 455 U.S. at 328 (Blackmun, J., dissenting).[23]

The question of retroactivity of decisions of this Court in the civil context is itself governed by the standards of *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 106-107 (1971). Under *Chevron Oil*, three factors must be considered: (1) as a prerequisite, "the decision . . . must establish a new principle of law, either by overruling clear past precedent

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[23] The majority decision in *Jewett* is not contrary to Petitioner's claim of unjust surprise here. The taxpayer in *Jewett* claimed unfairness in the retroactive application of a 1958 Treasury Regulation to an interest created in 1939. The Court disagreed, citing the fact, not the case here, that creation of the interest disclaimed postdated enactment of the 1932 Gift Tax Act. 455 U.S. at 317. The majority also noted that the taxpayer's disclaimer occurred long after the Regulation's issuance. *Id.* But there, neither *Keinath* nor the T.A.M. was the governing law.

on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed;" (2) the "prior history of the rule in question" must be reviewed to determine "whether retrospective operation will further or retard its operation;" and (3) the "inequity imposed by retroactive application" must be weighed, "for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity." 404 U.S. at 106-07. These factors easily demonstrate that the 1982 *Jewett* decision should not be applied retroactively to the 1917 transfer in trust by Petitioners' grandfather, or to his own 1979 disclaimer of the interest that then vested in him.

First, *Jewett* expressly overruled *Keinath*, on which Petitioner concededly relied, and which in turn perpetuated the common law rule that predated even the creation of the Trust. The case indeed represented a departure from the holdings of "virtually all courts" to have considered the question. Glushakow-Smith, Jewett v. Commissioner: *Unforeseen Crisis of Disclaimer*, 14 Loy. U. Chi. L.J. (1982). Second, retroactive application of a change in rules governing the gift tax could not promote the purposes of the changed construction of the gift tax laws because it would affect acts already performed. Indeed, the frustration of taxpayers' reasonable reliance upon settled law in the long-range planning of financial affairs would frustrate the policies that Congress, in enacting only prospective changes in the gift tax laws, has intended to promote. Protecting the reasonable reliance of parties upon prior law has been a cornerstone of this Court's retroactivity jurisprudence in the civil context. *See American Trucking Ass'ns, Inc.* v. *Smith*, 110 S. Ct. 2323, 2339-40 (1990); *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969).

Finally, and most pointedly, are the "substantial inequitable results" that would result from retroactive application of the *Jewett* rule. At no time prior to his disclaimer was Petitioner on notice that a failure to disclaim promptly might be at his own peril. In 1979, Petitioner had no notice that his disclaimer (as opposed to a decision to do nothing and accept the transfer) might subject him to millions of dollars in gift taxes immediately due and payable. To the contrary, he was informed by binding authority that it would not. If Petitioner's interest had not yet vested by 1982, the *Jewett* decision would have provided Petitioner with notice of a change in the law, at least with respect to post-Gift Tax Act trusts. As it was, however, Petitioner had no notice of any kind, and acted at all times in justifiable reliance upon authoritative and final statements of the law from the federal courts and the IRS.[24] That reasonable reliance now threatens to cost him millions of dollars.

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[24] Indeed, by the time Petitioner was placed on notice of his risk, the time under state law for him to have disclaimed would have long since passed.

CONCLUSION

For the reasons stated above, a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Eleventh Circuit on August 10, 1990.

Respectfully submitted,

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Dated: March 27, 1991

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
ELEVENTH CIRCUIT

No. 89-5753

JOHN G. ORDWAY and MARGARET M. ORDWAY,
Plaintiffs-Appellees,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court
for the Southern District of Florida

Aug. 10, 1990

Before FAY and JOHNSON, Circuit Judges, and GIBSON*, Senior Circuit Judge.

JOHNSON, Circuit Judge:

The United States ("the government") appeals from the district court's grant of summary judgment in favor of plaintiffs/appellees John G. Ordway, Jr. and Margaret M. Ordway ("taxpayers") and its order directing a refund of federal gift taxes paid by the taxpayers for the

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* Hon. Floyd R. Gibson, Senior U.S. Circuit Judge for the Eighth Circuit, sitting by designation.

calendar quarters ending September 30, 1979 and March 31, 1980.

I. STATEMENT OF THE CASE

On January 16, 1917, Lucius P. Ordway established an irrevocable inter vivos trust, administered under Minnesota law. He funded the trust with some 38,200 shares of Minnesota Mining and Manufacturing Company ("3M") stock and other assets. The trust provided that the trust income was to be paid to Lucius' wife and five children for their lives. On the death of the last surviving life beneficiary, the trust corpus was to be distributed to Lucius' grandchildren *per capita.* If any of the grandchildren died prior to termination of the trust, their share of the corpus would be distributed to their surviving issue *per stirpes.*

John G. Ordway, Jr., born on November 29, 1922, is one of Lucius Ordway's grandsons. At birth, he acquired a contingent remainder interest in the trust. John Ordway became aware of this interest in 1941, at age nineteen. On June 27, 1979, Katherine G. Ordway, taxpayer's aunt and last survivor of Lucius Ordway's wife and five children, died unmarried and without issue. At this point the trust terminated and the grandchildrens' contingent remainder interests vested. On August 23, 1979, John Ordway (then fifty-six years old) filed a partial disclaimer of his interest in the trust corpus.[1] He filed the disclaimer in the Ramsey County District Court of Minnesota, and the disclaimer was valid and effective under Minnesota law. As a result of the disclaimer, John Ordway's three children received the disclaimed portion of his interest *per stirpes.*

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[1] At his birth, John Ordway became entitled to one twenty-fifth of the trust income. When the trust terminated, he became entitled to one thirteenth of the corpus of the trust. Ordway disclaimed a twenty-four percent interest in the difference between one twenty-fifth of the corpus and one-thirteenth of the corpus, as well as some of the income.

On or about November 15, 1979, John Ordway filed a third quarter gift tax return with the Internal Revenue Service ("IRS"). He disclosed the 1979 disclaimer, but stated that the disclaimer was not a transfer subject to gift tax.[2] On March 19, 1982, following an audit of that return, John Ordway filed an amended 1979 third quarter gift tax return, and his wife Margaret Ordway filed an original third quarter gift tax return. Both of the returns treated the 1979 disclaimer as a taxable transfer under the gift tax provisions. They treated the gift as having been made one-half by each of them under Internal Revenue Code ("the Code") section 2513. The taxpayers each paid the taxes assessed against these returns. The IRS later assessed interest on the deficiencies, which the taxpayers also paid.

On March 10, 1980, John Ordway made a gift of 3M shares which was unrelated to the 1979 disclaimer. The taxpayers filed timely gift tax returns for the first quarter of 1980, treating the 1980 gift as having been made one-half by each of them. They paid the gift tax as reported. As a result of a subsequent audit, the IRS Commissioner asserted a deficiency in the 1980 first quarter tax for two reasons. First, because the disclaimer was deemed taxable in the third quarter of 1979, the taxpayers' respective

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[2] Under 26 C.F.R. § 25.2511-1(c), a disclaimed interest is not taxable if the disclaimer is valid under state law and is made within a reasonable time after the transfer that created the interest. John Ordway filed his disclaimer 38 years after he discovered his contingent remainder interest, but only two months after his interest vested. He relied on *Keinath v. Commissioner of Internal Revenue*, 480 F.2d 57 (8th Cir.1973), *overruled by Jewett v. Commissioner of Internal Revenue*, 455 U.S. 305, 102 S.Ct. 1082, 71 L.Ed.2d 170 (1982) in concluding that he did not owe gift tax on the disclaimed interest. The *Keinath* court held that "remainder interests that are not subject to divestiture should be disclaimed within a reasonable time after the testator's death, and where the remainder interest is subject to divestiture a disclaimer may be filed within a reasonable time after the termination of the life estate." *Keinath*, 480 F.2d at 63.

cumulative gift tax brackets for the first quarter of 1980 were increased. Second, the Commissioner disallowed a $240,068 blockage discount which the taxpayers had claimed on their 1980 returns.

The taxpayers paid the asserted deficiencies, then filed timely claims for refunds of those taxes and interest. The government disallowed the refund claims in full, finding that the disclaimer was a transfer subject to gift tax. On March 16, 1987, the taxpayers sued the government for recovery of the taxes and interest pursuant to 26 U.S.C.A. § 7422 and 28 U.S.C.A. § 1346(a)(1).

In March 1988, both parties submitted motions for summary judgment on the question of whether the 1979 disclaimer was taxable. The government contended that the Supreme Court's decision in *Jewett v. Commissioner*, 455 U.S. 305, 102 S.Ct. 1082, 71 L.Ed.2d 170 (1982), authorized the IRS to collect a gift tax on the disclaimed interest. The taxpayers disagreed. On March 13, 1989, the district court found that *Jewett* did not apply and that the taxpayers were entitled to refund of the gift taxes, and the court granted the taxpayers' motion for summary judgment. On May 16, 1989, the court ordered the government to refund $2,736,776.90 plus interest to John Ordway and $2,633,559.40 plus interest to Margaret Ordway. The government appeals.

On appeal, we must determine whether the district court erred in holding that John Ordway's partial disclaimer in 1979 of a vested remainder interest in an inter vivos trust created in 1917 was subject to the federal gift tax.[3]

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[3] There is some dispute between the parties regarding whether the Commissioner's disallowance of the $240,068 blockage discount claimed on the taxpayers' 1980 returns has been properly appealed. Both parties briefed the issue in the district court. The government asserted that the taxpayers did not raise the issue in their refund claims and therefore that the district court had no jurisdiction to hear the issue. It is not clear from the district court opinion

II. ANALYSIS

A. *Standard of Review*

The grant of a motion for summary judgment is subject to *de novo* review by this Court. *Shipes v. Hanover Ins. Co.*, 884 F.2d 1357, 1359 (11th Cir.1989).

B. *Whether Jewett Applies to an Interest Created Before 1932*

Section 2501(a)(1) of the Code imposes tax on the transfer of property by gift. That tax applies whether the gift is direct or indirect. Treasury regulation 26 C.F.R. § 25.2511-1(c) provides that an indirect transfer by means of disclamer is not a taxable gift if (1) the refusal to accept ownership is made within a reasonable time after knowledge of the existence of the transfer, (2) the refusal is unequivocable, and (3) the refusal is effective under local law. In *Jewett v. Commissioner*, 455 U.S. 305, 310, 102 S.Ct. 1082, 1086-87, 71 L.Ed.2d 170 (1982), the Supreme Court held that a "reasonable time" is measured from the date of the transfer which created the disclaimed interest, not from the date on which that interest vested. *Jewett*, 455 U.S. at 318-19, 102 S.Ct. at 1090-91.

In the present case, the district court found that *Jewett* did not apply to John Ordway's transfer by disclaimer of his vested remainder interest because *Jewett* was an interpretation of the federal gift tax. The court found that the gift tax did not apply to Lucius Ordway's trust because Lucius created the trust in 1917, prior to the exist-

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whether the district court found that it had jurisdiction or not. Before this Court, the government argues in a footnote that the district court did not discuss the blockage issue. The taxpayers, also in a footnote, state that the district court found that it had jurisdiction to decide the blockage issue. Because the parties do not argue the issue on appeal, this Court is not equipped to resolve it. On remand, the district court should clarify the blockage issue.

ence of a federal gift tax, and the gift tax specifically precludes retroactive application.[4] While these facts are true, they are not dispositive of this case.

The Revenue Act of 1924 was Congress' first attempt to pass a federal gift tax. In two different decisions, the Supreme Court held that this statute was unconstitutional because it imposed a gift tax on transfers made before the date of the Act. *See Untermyer v. Anderson*, 276 U.S. 440, 446, 48 S.Ct. 353, 354, 72 L.Ed. 645 (1928); *Blodgett v. Holden*, 275 U.S. 142, 147, 48 S.Ct. 105, 106-07, 72 L.Ed. 206 (1927). Congress passed the first valid gift tax in 1932, and that Act specifically stated that "[t]he tax shall not apply to a transfer made on or before the date of the enactment of this Act." Revenue Act of 1932, 47 Stat. 169, section 501(b).[5] It is clear, therefore, that

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[4] The district court also based its decision on the fact that the amount of money to which John Ordway was entitled could change at any time before the trust terminated if either new contingent remainderpersons were added or the value of the stocks in the corpus changed. The district court reasoned that because the value of John Ordway's interest was not fixed, it was impossible for the government to know the value of the taxable transfer until the trust terminated. It is not clear how this concern is relevant to the crucial issue in the case: whether John Ordway disclaimed his interest within a reasonable time of discovering his interest so that his disclaimer was not subject to the gift tax. How the government would have calculated a gift tax at any time before the disclaimer in 1979 has no relevance to this question. Further, the idea that transfer of a contingent remainder interest cannot be taxed until it vests was squarely refuted in *Jewett*. The *Jewett* Court stated that because a disclaimer may decide to retain the disclaimed contingent remainder interest, the disclaimer of a contingent remainder interest is a taxable gift. *Jewett*, 455 U.S. at 317-18, 102 S.Ct. at 1090-91. *See also Jewett*, 455 U.S. at 315, 102 S.Ct. at 1089 ("the purpose of the change in [26 C.F.R. § 25.2511-1(c)] was not to exclude contingent remainders").

[5] *Cf. Hassett v. Welch*, 303 U.S. 303, 314, 58 S.Ct. 559, 565, 82 L.Ed. 858 (1938) ("a law is presumed, in the absence of clear expression to the contrary, to operate prospectively; . . . if doubt exists as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer . . . .").

Lucius Ordway's transfers to his heirs by means of the trust are not subject to the gift tax. What is questionable is whether John Ordway's indirect transfer of his interest by means of the disclaimer executed in 1979 acted as a separate, taxable transfer.[6]

Two different Treasury regulations treat disclaimers as separate taxable transfers. Volume 26 C.F.R. § 25.2511-1(c)(2) states:

> In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent . . . . a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer.[7]

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[6] The taxpayers argue that the Supreme Court resolved this question in *Jewett* by means of the following sentence: "Indeed, petitioner does not argue that taxation of the disclaimers is inconsistent with the statutory provisions imposing a gift tax, which were enacted long before petitioner's interest in the trust was created." *Jewett*, 455 U.S. at 317, 102 S.Ct. at 1090. The taxpayers claim that in this sentence the Supreme Court established that a disclaimer is subject to taxation only if the interest disclaimed was created after the statutory provisions imposing a gift tax were enacted. Even read out of context, this sentence does not state clearly the proposition urged by the taxpayers. Read in context, it is clear that the Court held that because Jewett made his disclaimer subsequent to the enactment of 26 C.F.R. § 25.2511-1(c), he could not claim lack of notice regardless of when his interest was created. The same is true in John Ordway's case. Because John Ordway disclaimed his interest long after 26 C.F.R. § 25.2511-1(c) was promulgated, he cannot claim that he had no notice that disclaimers constituted taxable transfers.

[7] This version is the result of a 1986 amendment. Thus the regulation read differently at the time that John Ordway made his disclaimer. Unless the Secretary prescribes otherwise, however, tax regulations apply retroactively. 26 U.S.C.A. § 7805(b).

Title 26, U.S.C.A. § 2518(a) states: "For the purposes of this subtitle, if a person makes a qualified disclaimer with respect to any interest in property, this subtitle shall apply with respect to such interest as if the interest had never been transferred to such person." [8] Section 2518(a) applies to disclaimers of interests created by taxable transfers made after December 31, 1976. Pub. L. 94-455, Title XX, § 2009(b)(1), Oct. 4, 1976, 90 Stat. 1893. Under section 2518, then, disclaimers do not act as taxable transfers because they function to pass the interest from the donor (in this case, Lucius Ordway) to the disclaimee (in this case, John Ordway's three children),[9] while under section 25.2511-1(c), disclaimers do act as taxable transfers unless they meet two specific conditions.

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[8] A qualified disclaimer is (1) an irrevocable refusal to accept an interest (2) in writing (3) received by the transferor or the holder of legal title no later than nine months after the later of the transfer creating the interest or the disclaimer's twenty-first birthday where (4) the disclaimer has not accepted the interest or its benefits and (5) the interest passes without any direction on the disclaimer's part to either the spouse of the decedent or a person other than the disclaimer. 26 U.S.C.A. § 2518(b).

[9] This provision is logically the more attractive, because it is difficult to comprehend why one should be taxed for transferring an interest from which one never has benefitted. It is quite clear, however, that the government does tax such interests, even if the transferor might never have benefitted from the interest. In *Jewett*, for example, the transferor disclaimed a contingent remainder interest which would have vested only if he survived his mother. *Jewett*, 455 U.S. at 306, 102 S.Ct. at 1084-85. Unlike the interest in the present case, Jewett's interest had not vested at the time of disclaimer; not only did he not accept his interest before disclaiming it, but he was incapable of doing so. Even though Jewett might have predeceased his mother and never benefitted from his interest, the Supreme Court held that the disclaimer constituted a taxable transfer. Under *Jewett*, therefore, it is clear that a transferor may be taxed for transferring an interest from which he has never actually benefitted.

Before deciding which provision applies to John Ordway's disclaimer, however, we first must decide whether Lucius Ordway's original transfer was the kind of transfer which would bring the disclaimer under these provisions. Both provisions assume that disclaimers are created by *taxable* transfers. As discussed above, Lucius Ordway's original transfer, which created the interest that John Ordway disclaimed in 1979, was not taxable in the sense that it was made before the gift tax existed. In discussing when a disclaimer must be delivered to the transferor under section 25.2518, however, the Treasury regulations explain that, "With respect to inter vivos transfers, a taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift." 26 C.F.R. § 25.2518-2(c)(3). For the purposes of measuring time, then, a taxable transfer occurs whenever there happens "any transaction in which an interest in property is gratuitously passed or conferred upon another," 26 C.F.R. § 25.2511[-1](c)(1), even if that transaction was not subject to the gift tax. Under this definition, Lucius Ordway's 1917 gift is a taxable transfer for measuring purposes, even though it was not subject to tax.

Having concluded that the 1917 gift was a taxable transfer, it is a simple matter to determine which provision applies. Because Ordway made the original transfer before January 1, 1977, 26 C.F.R. § 25.2511-1(c)(2) applies. Under that regulation, all disclaimers of interests created by taxable transfers made before January 1, 1977, are subject to the federal gift tax unless the disclaimer was valid under state law and was made within a reasonable time of the knowledge of the existence of the transfer. We now must determine whether John Ordway's disclaimer met these two requirements.

C. *Whether the Taxpayer Filed his Disclaimer Within a Reasonable Time.*

It is undisputed that John Ordway's 1979 disclaimer was valid under Minnesota law.[10] The government argues, however, that the disclaimer was not made "within a reasonable time after knowledge of the existence of the transfer," because John Ordway learned of his contingent remainder interest in 1941, but did not disclaim it until 1979. Under the reasoning in *Jewett v. Commissioner*, this argument is correct. The *Jewett* Court held that for the purposes of section 25.2511-1(c), the transfer of property occurs at the time of the decedent's death, not at the time of the vesting of the interest in the beneficiary. *Jewett*, 455 U.S. at 318-19, 102 S.Ct. at 1090-91. Under *Jewett*, therefore, the transfer in the taxpayers' case occurred in 1917.[11] John Ordway received knowledge of the transfer in 1941, and reached the age of majority in 1943. Yet he did not disclaim his interest until thirty-eight years after he received knowledge of the transfer and thirty-six years after he reached the age of majority. This is some twelve to fourteen years over the twenty-four year period which the Supreme Court found unacceptable in *Jewett*.

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[10] Under Minnesota law a valid disclaimer must be filed within six months of the event which causes the disclaimant to be finally ascertained and his interest to be indefeasibly fixed, and must be filed in a Minnesota district court. Minn.Stat. § 501.211, subds. 1(c), 3, 4.

[11] Under Minnesota law, a disclaimer is filed within a reasonable time if it is filed within six months of the event which causes the disclaimant's interest to become indefeasibly fixed. Minn.Stat. § 501.211, subd. 3. State law controls a federally taxed revenue, however, "only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law." *Burnet v. Harmel*, 287 U.S. 103, 110, 53 S.Ct. 74, 77 77 L.Ed. 199 (1932). The federal taxing act regarding reasonable time does not make its operation dependent on state law, therefore Minnesota law does not control.

The Supreme Court did not decide *Jewett* until three and a half years after John Ordway filed his disclaimer and over three years after he first reported the disclaimed amount to the IRS. Before the *Jewett* decision, the definition of "reasonable time" in the Eighth Circuit [12] was the definition provided in *Keinath v. Commissioner of Internal Revenue*, 480 F.2d 57 (8th Cir. 1973), *overruled by Jewett v. Commissioner of Internal Revenue*, 455 U.S. 305, 102 S.Ct. 1082, 71 L.Ed.2d 170 (1982). The *Keinath* court held that if a remainder interest was subject to divestiture, a disclaimer of that interest should be filed within a reasonable time after the termination of the life estate. *Id.* at 63. Because John Ordway's interest was contingent on his surviving all of Lucius Ordway's children, the interest was subject to divestiture. Under *Keinath*, therefore, John Ordway's disclaimer had to be filed within a reasonable time after termination of the life estate. The life estate terminated with Katherine Ordway's death on June 27, 1979, and John Ordway filed his disclaimer two months later, clearly within a reasonable time as defined by *Keinath*.

On appeal neither party discusses whether it is appropriate to apply the *Jewett* decision retroactively to John Ordway's disclaimer. Although there has been no clear holding on the issue, at least two justices on the Supreme Court and one judge on this Court consider non-retroactivity to be an affirmative defense, which is waived if it is not raised. *See Zant v. Moore*, [489 U.S. 836,] 109 S.Ct. 1518, 1519, 103 L.Ed.2d 922 (1989) (Blackmun, J., dissenting) ("petitioner did not raise nonretroactivity as a defense to respondent's claim . . . , and that defense therefore should be deemed waived"); *Penry v. Lynaugh*, —— U.S. ——, 109 S.Ct. 2934, 2963, 106 L.Ed.2d 256 (1989) (Stevens, J., concurring in part and dissenting in part) ("Nor am I at all sure that

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[12] The taxpayers lived in Minnesota at the time of the events giving rise to this appeal.

courts should decide the retroactivity issue if it was not raised below."); *Moore v. Zant*, 885 F.2d 1497, 1524 (11th Cir.1989) (Johnson, J., dissenting) ("It appears that non-retroactivity is an affirmative defense. *See United States v. Francischine*, 512 F.2d 827, 830 (5th Cir.), *cert. denied*, 423 U.S. 931, 96 S.Ct. 284, 46 L.Ed.2d 261 (1975)"). *But see Teague v. Lane*, 489 U.S. 288, 109 S.Ct. 1060, 1069, 103 L.Ed.2d 334 (1989) (Supreme Court may address nonretroactivity issue *sua sponte*); *Moore v. Zant*, 885 F.2d at 1519 n. 5 (Kravitch, J., dissenting) (permitting state to waive *Teague v. Lane* nonretroactivity principles would result in unfairness and disparate treatment); *White v. Finkbeiner*, 753 F.2d 540, 543 (7th Cir.1985) (while nonretroactivity may be an affirmative defense subject to waiver, appellate court will consider nonretroactivity when Supreme Court *sua sponte* orders it to do so); *Weaver v. Bowers*, 657 F.2d 1356, 1362 (3rd Cir.1981), *cert. denied*, 455 U.S. 942, 102 S.Ct. 1435, 71 L.Ed.2d 653 (1982) (although nonretroactivity was not timely raised, the court will consider the issue because unusual circumstances require it). Following this reasoning, we find that the taxpayers' failure to raise the nonretroactivity defense constitutes a waiver of that defense. Thus *Jewett* applies, with the result that John Ordway did not file his disclaimer within a reasonable time after obtaining knowledge of the transfer creating his interest, causing the disclaimed interest to be subject to the gift tax.

III. CONCLUSION

For the reasons stated above, we REVERSE the district court's grant of summary judgment in favor of the taxpayers. We REMAND, however, for further proceedings on the issue of the Commissioner's disallowance of the blockage discount.

FLOYD R. GIBSON, Senior Circuit Judge, dissenting:

I respectfully dissent. I would apply the law as it stood at the time when the taxpayer executed his disclaimer in 1979. This court is not strictly bound to apply *Jewett* in this case because Ordway failed to argue its nonretroactivity. As the majority opinion even admits, courts have excused a party's failure to invoke the correct law where justice so requires.

Here, the interests of justice and fundamental fairness compel this court to judge this case according to the rules that applied when Ordway filed his disclaimer. Particularly in the area of the tax laws, it is important that citizens are provided notice of the laws so that they have a meaningful chance to observe and plan according to them. *See Jewett*, 455 U.S. at 324, 102 S.Ct. at 1093-94 (Blackmun, J., dissenting). In this case, the majority holds that the clock began ticking for Ordway in 1941 when he became aware of his interest, even though *Jewett*, the case that determined when the clock began ticking, was not decided until 1982. Under today's holding Ordway will suffer severe tax consequences for failing to do something at a time when the law provided him with no notice that he needed to act. I do not believe that allegiance to the rules of procedure is a satisfactory justification for producing such a result.

The sort of unfairness that is visited upon Ordway was well described by Justice Blackmun in *Jewett*, where Justice Blackmun dissented from the unfair result imposed on the petitioner in that case. Justice Blackmun stated that expecting Jewett, the contingent remainderman, to disclaim his interest within a reasonable time of the testatrix' death meant that Jewett had to disclaim the interest before he knew its full extent, before he knew whether the interest would ever vest at all, and before he actually obtained any enjoyment out of the interest. Justice Blackmun stated:

> The Court's and the Commissioner's position [in *Jewett*] also seems to me to embrace a distinct element of unfairness. The Commissioner stresses repeatedly the number of years that elapsed between the death of the testatrix and the execution of the disclaimers. This same element has been stressed in others of these cases. But to require the disclaimer long before the interest could ripen into enjoyment means that the decision must be made at a time when the disclaimant does not know what he is disclaiming or whether he ever would receive and enjoy any interest.

Jewett, 455 U.S. 305, 102 S.Ct. at 328 (1982) (Blackmun, J., dissenting).

Courts have considerable discretion to excuse, in the interest of justice, a party's failure to raise particular issues. I believe the court should exercise that discretion here in order to avoid this unfairness. I would hold that under *Keinath v. Commissioner of Internal Revenue*, 480 F.2d 57 (8th Cir.1973), Ordway's disclaimer is not subject to the gift tax because it was filed within a reasonable time after the termination of the life estate in June 1979.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 87-8187

JOHN G. ORDWAY, JR. and MARGARET M. ORDWAY,
Plaintiffs,

v.

UNITED STATES OF AMERICA,
Defendant.

MEMORANDUM OPINION

[Filed Mar. 13, 1989]

John and Margaret Ordway seek to recover gift taxes and interest which they contend were erroneously assessed and collected by the Commissioner of the Internal Revenue Service. The Commissioner opposes the relief, contending the assessment was proper. The pending cross motions for summary judgment present a pure legal issue which will be resolved by our Memorandum Opinion.

I. BACKGROUND

1. On January 16, 1917, Lucius P. Ordway established an inter vivos trust, the term of which was for the lives of the survivor of his wife and five children.

2. The Plaintiff, John G. Ordway, Jr., was born on November 29, 1922. He is the grandson of Lucius P. Ordway. By virtue of his birth, John obtained a contingent remainder interest in the trust, subject to his surviving the term of the trust and his acceptance of the remainder

interest. The percentage of his interest was subject to change until the termination of the trust, depending upon the birth or death of additional contingent beneficiaries. The value of John's interest in the trust was also subject to fluctuations in the value of the assets within the trust and the lifespan of the life beneficiaries of the trust.

3. As early as December 31, 1941, at age 19, John learned that he was a contingent remainderman of an interest in the trust.

4. On June 27, 1979, Katherine G. Ordway, the last survivor of Lucius P. Ordway's wife and children, died unmarried. Katherine G. Ordway was John's aunt. She was the youngest daughter of Lucius P. Ordway. Her death caused the trust to terminate.

5. The trust was administered under Minnesota law where proceedings in rem within the district court for that state were pending.

6. On August 23, 1979, John partially disclaimed his interest in the corpus of the trust by filing a document entitled Partial Disclaimer of John G. Ordway, Jr. The disclaimer was in accordance with and valid under Minnesota law. John never accepted any interest in the portion of the trust disclaimed.

7. At the time of the disclaimer, John and Margaret had three children. Under Minnesota law, as a consequence of his disclaimer, his children received, per stirpes, his interest in the trust.

8. In November, 1979, John filed his 1979 third quarter gift tax return with the Internal Revenue Service, which fully disclosed the 1979 disclaimer. The disclaimer was not treated in that return as a transfer subject to tax. Subsequently, in the course of an audit of that return, John Ordway filed an amended gift tax return for the third quarter of 1979; and Margaret filed an original gift tax return for the third quarter of 1979. Margaret's

return treated the disclaimer as a transfer which was subject to gift tax.

9. In his amended gift tax return for the third quarter of 1979 and in her gift tax return for the third quarter of 1979, John and Margaret consented to have the gift made by their spouse to third parties during that quarter considered as having been made one-half by each of them. John and Margaret paid the additional gift tax due on their respective gift tax returns for the third quarter of 1979 in the amounts of $930,647.37 and $861,412.53 respectively. Margaret and John were assessed and paid interest on the alleged tax due for the third quarter of 1979.

10. John and Margaret filed claims for refund for gift tax paid for the third quarter of 1979, plus interest. On March 21, 1985, Plaintiffs received notice from the Commissioner that their claims for refund were disallowed in full.

11. On March 10, 1980, John made a gift of 3M stock, the same type held by the trust, but unrelated to the 1979 disclaimer. On or before April 15, 1980, John and Margaret filed gift tax returns for the first quarter of 1980. Those returns fully disclosed that gift and enclosed the gift tax due. In their first quarter 1980 gift tax returns, John and Margaret consented to have any gifts made by their spouse to third parties during that quarter considered as having been made one-half by each of them. In the course of a subsequent audit, the Commissioner assessed John and Margaret a gift tax deficiency for the first quarter of 1980, resulting from the Commissioner's assertion that the disclaimer occurring in the third quarter of 1979 constituted a gift and from the Commissioner's disallowance of a $240,068.00 discount claimed on that return regarding the value of 120,034 shares of 3M stock valued on February 10, 1980. The Ordways paid the asserted deficiencies at the times and in the amounts demanded.

12. John and Margaret subsequently filed claims for refund for gift tax paid for the first quarter of 1980. On March 21, 1985, Plaintiffs received notice from the Commissioner that their claims for refund for the first quarter of 1980 were disallowed in full. On both occasions when the refunds were disallowed, the Commissioner determined that the transfer was made subject to the gift tax requirements.

13. John and Margaret Ordway commenced this action pursuant to Internal Revenue Code, 28 U.S.C. § 7422 (1986) and 28 U.S.C. § 1346(a)(1).

II. DISCUSSION

A. *Jurisdiction*

The Commissioner contests the Court's jurisdiction arguing that Plaintiffs' claim filed with the IRS was not raised in a timely administrative claim for refund prior to the initiation of this action. *See* Section 7422(a), Internal Revenue Code and Treasury Regulation § 301.6401-2(b)(1). Plaintiffs allege that they have met the requirements of Section 7422.

Section 7422(a) of the Internal Revenue Code provides:

> No suit shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected or if any penalty claim to have been collected without authority, or if any sum alleged to have been or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate established in pursuance thereof.

Further requirements for civil actions for refund are set forth in Treasury Regulation § 301.6402-2(b)(1) which states in pertinent part:

> The claim must set forth in detail each ground upon which a credit or refund is claimed and facts suffi-

cient to apprise the Commissioner of the exact basis thereof.

Our review of the record determines that the Ordways filed their claims for refund in a timely manner. The claims stated in sufficient detail grounds upon which their refund was claimed in order to apprise the Commissioner of the basis for the refund. We find no variance in Plaintiffs' claim for refund and the instant complaint. The grounds advanced by the Ordways here were fully asserted in their timely filed claims for refunds. Accordingly, we find that § 7422 has been satisfied; thus jurisdiction is proper.

B. *Federal Law vs. State Law*

Plaintiffs contend that the disclaimer was made in accordance with applicable state law and involved a refusal to accept a property interest created at a time when there was no federal gift tax statute. Accordingly, they argue that there should be no federal gift tax consequences. On the other hand, the Commissioner argues that while the Plaintiffs may have complied with state law, they have not complied with either the federal gift tax statute or the treasury regulations. Specifically, under Treasury Regulation Section 25.2511-1(c)[1], a beneficiary may refuse to accept ownership, but such a refusal must be made within a reasonable time after knowledge of the existence of the transfer. The Commissioner argues that John Ordway knew of the existence of the contingent remainder as early as 1941 but did not disclaim that

[1] Section 25.2511-1(c) of the Regulations provides:

Where the law governing the administration of the decendent's estate gives a beneficiary, heir, or next of kin a right to completely and unqualifiedly refuse to accept ownership of the property transferred from a decedent . . . a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable and effective under local law . . .

interest until 1979. That disclaimer, the Commissioner asserts, was not made within a reasonable time after knowledge of the existence of the transfer. Treas. Reg. § 25.2511-1(c). Two cases relied upon by the Commissioner are *Jewett v. Commissioner*, 455 U.S. 305, 102 S.Ct. 1082, 71 L.Ed.2d 170 (1982) and *Fuller v. Commissioner*, 37 T.C. 147 (1961).

In *Jewett*, a testamentary trust was created in 1939. Under the terms of the trust, George Jewett, then 11 years old, obtained a contingent remainder interest at the time the trust was created. In 1972, George disclaimed any interest in the corpus of the trust. Under state law, the trustee treated George as if deceased, making his children the direct beneficiaries of his half share of the corpus, then worth more that [sic] $8 million. The Supreme Court held that George's interest in the corpus was created in 1939, and, unless disclaimed within a reasonable time thereafter would be treated as received by him and given to his children. The transfer was found to have occurred when George's interest was created, not at a later time when the interest vested or became possessory. The Court further held that George's disclaimer 33 years after he reached the age of majority was not made within a reasonable time and was therefore subject to tax.

In response, Plaintiffs contend that *Jewett* is inapplicable to this case because Treasury Regulation 25.2511-1 (c) only applies to property interest created by transfers that have tax consequences. In other words, the regulation only applies to transfers occurring after the enactment date of the Revenue Act of 1932. That Act states that the tax shall not apply to a transfer made on or before the date of the enactment of the Act. Revenue Act of 1932, 3501(b).

Plaintiffs argue that the transfers referred to in the regulation occurred in 1917 with the creation of the trust. As gift taxes were not imposed on inter vivos transfers in trust in 1917, Plaintiffs assert that the creation of the

trust was neither a transfer within the meaning of *Jewett* nor a transfer within the reach of § 25.2511-1(c). In furtherance of their argument, Plaintiffs contend that federal gift tax laws, like the Revenue Act of 1932, are always applied on a prospective and never on a retroactive basis. *Blodgett v. Holden*, 275 U.S. 142 (1927).

The second case argued by the Commissioner is *Fuller v. Commissioner*, 37 T.C. 147 (1961). In that case, the petitioner was bequeathed with certain property interests at the time of her husband's death in 1931, prior to the enactment of the Revenue Act of 1932. Included in the interests she received was a life income interest in five-eighths of the trust created under the decedent's will. For more than 20 years, the petitioner accepted the income from the trust. In 1956, she executed a disclaimer in which she purported to have previously "released, disclaimed, and renounced" her past, present and future rights to receive income from three-eighths or [sic] the trust. *Id.* at 151. The Tax Court held that the 1956 disclaimer of the interest in the trust created in 1931 was subject to gift tax under § 25.2511-1(c). Although the trust was created prior to the enactment of the 1932 Act, the Tax Court ruled in favor of the Commissioner because it placed the date of "transfer" as the date the interest vested or became possessory. As observed by the Court, "[b]y the time of the 'renunciation', the administration of the estate had continued for almost a quarter century, during all of which petitioner had accepted, directly or indirectly, the benefits conferred upon her by the will . . . it would be difficult to conclude that petitioner's conduct had not constituted an 'acceptance'." *Id.* "There can be no refusal of ownership of property after its acceptance." Treas. Reg. § 25.2511-1(c).

Plaintiffs contend that the factual circumstances of *Fuller* are substantially and compellingly different than the factual circumstances of this case. In *Fuller*, a fixed life estate, though created prior to 1932, was fully en-

joyed and accepted by the petitioner until her disclaimer in 1956. On the other hand, Plaintiffs argue that John Ordway's interest was a contingent future interest which did not become fixed until 1979 with the death of Katherine Ordway. At no time did John Ordway accept any interest whatsoever in the property interest disclaimed, nor did he receive any income from the portion of the trust disclaimed. Finally, Plaintiffs contend that *Fuller* was decided before *Jewett*, and therefore did not have the benefit of the *Jewett* decision which requires the relating-back of the disclaimer to the time the interest was created, and not the date the interest vested or became possessory. *Jewett* applied in this case would require a relation back to a time prior to the enactment of the Revenue Act of 1932. Thus, John's disclaimer in 1979 would relate back to the establishment of the trust in 1917. Instead of John being the ultimate recipient, it would be treated as if John never had an interest, but that his children were the beneficiaries from the creation of the trust. *See Kennedy v. Commissioner*, 804 F.2d 1332, 1334 (7th Cir. 1986).

C. *Legal Analysis*

The issue in this case is one of first impression, although generation skipping is a familiar subject in tax and estate law. We are here to ultimately determine what rules properly govern the refusal to accept a property interest which was created before the enactment of the 1932 gift tax statute.

At the outset, we acknowledge that *Jewett* and *Fuller* present situations which at first blush appear to be controlling in this case. However, upon closer consideration, we do not find either to be persuasive. *Jewett* is distinguishable because the creation of the trust and all surrounding circumstances occur after the enactment of the Revenue Act of 1932. While *Jewett* establishes the date of "transfer" as the date the interest was created, the Act expressly precludes retroactive application to trust inter-

ests created prior to its enactment. In *Fuller*, Kathryn Fuller had accepted the property interest. In that regard, *Fuller* is a very narrow holding which no longer applies in light of the Supreme Court's decision in *Jewett*.

In this case we have four critical factors which weigh heavily in Plaintiffs' favor. First, the value and percentage of John's interest was subject to change until the termination of the trust. The inability to determine the value of Ordway's interest made it impossible to value the amount of gift tax to be assessed until the trust terminated. *See Kennedy v. Commissioner*, 804 F.2d at 1335. Second, John Ordway never had any control over the assets of the trust until the date of termination in July, 1979. Third, Ordway never received or accepted any portion of the trust interest which he disclaimed on August 23, 1979. Finally, and most importantly, the trust was created in 1917, prior to the gift tax imposed by the enactment of the Revenue Act of 1932. That Act expressly precludes retroactive application.

Based on the facts of this case, we find the disclaimer executed by John Ordway occurred promptly after the death of the last surviving life tenant of the trust. As there was no method to determine the value of John Ordway's interest in the trust until its termination, there could be no effective disclaimer until that date. The disclaimer was made and was valid in accordance with Minnesota state law. Since the interest was created prior to the enactment of the 1932 Act, state law compliance is all that is required. *See Kennedy v. Commissioner*, 804 F.2d at 1335.

III. CONCLUSION

In accordance with our opinion herein, it is ORDERED and ADJUDGED as follows:

1. Plaintiffs' Motion for Summary Judgment is GRANTED.

2. Defendant's Motion for Summary Judgment is DENIED.

3. Within twenty (20) days from the date of this Order, the Plaintiffs shall submit a statement as to the amount of recovery they seek to be refunded, including accrued interest, claim for all fees and costs. The Commissioner shall have ten (10) days within which to respond. The Plaintiffs shall have five (5) days to reply.

DONE and ORDERED in Chambers at Miami, Florida this 13th day of March, 1989.

/s/ Thomas E. Scott
THOMAS E. SCOTT
United States District Judge

Copies mailed to:

Burton G. Ross, Esquire
Thomas M. Mettler, Esquire
Alvarez L. LeCesne, Jr., Esquire
Elizabeth Ruf Stein AUSA-Miami

[CLOSED CIVIL CASE]

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Civil No. 87-8187-Civ-Scott

JOHN G. ORDWAY, JR. and MAGARET M. ORDWAY,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendants.

FINAL JUDGMENT

[Filed May 16, 1989]

This cause having come on before the Court by Plaintiffs' Motion for Summary Judgment and Defendant's Motion for Summary Judgment and this Court having entered its Memorandum Opinion filed March 13, 1989 ordering that Plaintiff's Motion for Summary Judgment is granted and that Defendant's Motion for Summary Judgment is denied and this Court having received Plaintiff's Calculations of Amounts Due and having ordered that the calculation be deemed unopposed under Local Rule 10(c).

IT IS HEREBY ORDERED AND ADJUDGED that final judgment in favor of Plaintiffs, John G. Ordway, Jr. and Margaret M. Ordway, against Defendant, United States of America, is hereby granted and ordered entered as the judgment in this action as follows:

1. In favor of John G. Ordway, Jr. in the amount of Two Million Seven Hundred Thirty-Six Thousand

Seven Hundred Seventy-Six and 90/100 Dollars ($2,736,776.90) together with interest on that amount from and after May 9, 1989 at the statutory rates specified by 28 USC § 2411 and §§ 6611, 6621 and 6622 of the Internal Revenue Code.

2. In favor of Margaret M. Ordway in the amount of Two Million Six Hundred Thirty-Three Thousand Five Hundred Fifty-Nine and 40/100 Dollars ($2,633,559.40) together with interest on that amount from and after May 9, 1989 at the statutory rates specified by 28 USC § 2411 and §§ 6611, 6621 and 6622 of the Internal Revenue Code.

3. In favor of John G. Ordway, Jr. and Margaret M. Ordway, jointly, for the following costs allowed in this matter:

Filing Fee	$120.00
Process Service	10.00
Total	$130.00

DONE and ORDERED in Chambers at Miami, Florida on the 16 day of May, 1989.

/s/ Thomas E. Scott
THOMAS E. SCOTT
United States District Judge

cc: Burton G. Ross, Esq.
Thomas M. Mettler, Esq.
Alvarez L. LeCesne, Jr., Esq.
Elizabeth Ruf Stein AUSA

APPENDIX D

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 89-5753

JOHN G. ORDWAY and MARGARET M. ORDWAY,
Plaintiffs-Appellees,

versus

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court
for the Southern District of Florida

ON PETITION(S) FOR REHEARING AND
SUGGESTION(S) OF REHEARING IN BANC

[Filed Nov. 11, 1990]

Before: FAY and JOHNSON, Circuit Judges and GIBSON*, Senior Circuit Judge.

PER CURIAM:

(✓) The Petition(s) for Rehearing are DENIED and no member of this panel nor other Judge in regular ac-

---

* Honorable Floyd R. Gibson, Senior Circuit Judge for the United States Court of Appeals 8th Circuit, sitting by designation.

tive service on the Court having requested that the Court be polled on rehearing in banc (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing In Banc are DENIED.

ENTERED FOR THE COURT:

/s/ Frank M. Johnson, Jr.
United States Circuit Judge

APPENDIX E

STATUTORY PROVISIONS

U.S. Const., amend. V (pertinent part):

> No person shall be deprived of life, liberty, or property, without due process of law.

Internal Revenue Code (26 U.S.C.):

§ 2501. Imposition of tax

(a) Taxable transfers.—

(1) General rule.—A tax, computed as provided in section 2502, is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

* * * *

§ 2502. Rate of tax

(a) Computation of tax.—The tax imposed by section 2501 for each calendar year shall be an amount equal to the excess of—

(1) a tentative tax, computed under section 2001(c), on the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

(2) a tentative tax, computed under such section, on the aggregate sum of the taxable gifts for each of the preceding calendar periods.

(b) Preceding calendar period.—Whenever used in this title in connection with the gift tax imposed by this chapter, the term "preceding calendar period" means—

(1) calendar years 1932 and 1970 and all calendar years intervening between calendar year 1932 and calendar year 1970,

(2) the first calendar quarter of calendar year 1971 and all calendar quarters intervening between such calendar quarter and the first calendar quarter of calendar year 1982, and

(3) all calendar years after 1981 and before the calendar year for which the tax is being computed.

For purposes of paragraph (1), the term "calendar year 1932" includes only that portion of such year after June 6, 1932.

* * * *

§ 2511. Transfers in general

(a) Scope.—Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

* * * *

Revenue Act of 1932, § 501(b), 42 Stat. 169 (1932):

(b) The tax shall not apply to a transfer made on or before the date of enactment of this act [June 6, 1932].

Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009 (e)(2), 90 Stat. 1896 (1976):

(e) EFFECTIVE DATE.—

* * * *

(2) FOR SUBSECTION (b).—The amendments made by subsection (b) shall apply with respect to transfers creating an interest in the person disclaiming made after December 31, 1976.

Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 426(b), 95 Stat. 318 (1981):

> (b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to transfers creating an interest in the person disclaiming made after December 31, 1981.

Treasury Regulations (26 C.F.R.):

§ 25.2511-1 Transfers in general.

(a) The gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. For example, a taxable transfer may be effected by the creation of a trust, the forgiving of a debt, the assignment of a judgment, the assignment of the benefits of an insurance policy, or the transfer of cash, certificates of deposit, or Federal, State or municipal bonds. Statutory provisions which exempt bonds, notes, bills and certificates of indebtedness of the Federal Government or its agencies and the interest thereon from taxation are not applicable to the gift tax, since the gift tax is an excise tax on the transfer, and is not a tax on the subject of the gift.

* * * *

§ 25.2511-1(c) (1958)

(c) The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax. See further § 25.2512-8. Where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right to completely

and unqualifiedly refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution of interstate property), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable and effective under the local law. There can be no refusal of ownership of property after its acceptance. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. . . .

§ 25.2511-1(c) (1986)

(c) (1) The gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax. See further § 25.2512-8 relating to transfers for insufficient consideration. However, in the case of a taxable transfer creating an interest in the person disclaiming made after December 31, 1976, this paragraph

(c) (1) shall not apply to the donee if, as a result of a qualified disclaimer by the donee, the property passes to a different donee. Nor shall it apply to a donor if, as a result of a qualified disclaimer by the donee, a completed transfer of an interest in property is not effected. See section 2518 and the corresponding regulations for rules relating to a qualified disclaimer.

(2) In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law. There can be no refusal of ownership of property after its acceptance. In the absence of the facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into

account the recognition and effectiveness of such a purported refusal under the local law. . . .

§ 25.2511-1(g)

(g) (1) Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor. However, there are certain types of transfers to which the tax is not applicable. It is applicable only to a transfer of a beneficial interest in property. It is not applicable to a transfer of bare legal title to a trustee. A transfer by a trustee of trust property in which he has no beneficial interest does not constitute a gift by the trustee (but such a transfer may constitute a gift by the creator of the trust, if until the transfer he had the power to change the beneficiaries by amending or revoking the trust). The gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth, or to ordinary business transactions, described in § 25.2512-8.

(2) If a trustee has a beneficial interest in trust property, a transfer of the property by the trustee is not a taxable transfer if it is made pursuant to a fiduciary power the exercise or nonexercise of which is limited by a reasonably fixed or ascertainable standard which is set forth in the trust instrument. A clearly measurable standard under which the holder of a power is legally accountable is such a standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; to enable him to maintain his accustomed standard of living; or to

meet an emergency, would be such a standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not such a standard. The entire context of a provision of a trust instrument granting a power must be considered in determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no such standard exists.

§ 25.2518-1 Qualified disclaimers of property; in general.

(a) Applicability—(1) In general. The rules described in §§ 25.2518-1 through 25.2518-3 apply to the qualified disclaimer of an interest in property which is created in the person disclaiming by a taxable transfer made after December 31, 1976. In general, a qualified disclaimer is an irrevocable and unqualified refusal to accept the ownership of an interest in property. For rules relating to the determination of when a transfer occurs, see § 25.2518-2 (c) (3) and (4).

* * * *

§ 25.2518-2(c)(3)

(c) *Time Limit—*

* * * *

(3) Transfer. For purposes of the time limitation described in paragraph (c) (1) (i) of this section, the 9-month period for making a disclaimer generally is to be determined with reference to the taxable transfer creating the interest in the disclaimant. With

respect to inter vivos transfers, a taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift. Thus, gifts qualifying for the gift tax annual exclusion under section 2503(b) are regarded as taxable transfers for this purpose. With respect to transfers made by a decedent at death or transfers which become irrevocable at death, a taxable transfer occurs upon the date of the decedent's death. However, where there is a taxable transfer of an interest for Federal gift tax purposes and such interest is later included in the transferor's gross estate for Federal estate tax purposes, the 9-month period for making a qualified disclaimer is determined with reference to the earlier taxable transfer. In the case of a general power of appointment, the holder of the power has a 9-month period after the creation of the power in which to disclaim. A person to whom any interest in property passes by reason of the exercise or lapse of a general power may disclaim such interest within a 9-month period after the exercise or lapse. In the case of a nongeneral power of appointment, the holder of the power, permissible appointees, or takers in default of appointment must disclaim within a 9-month period after the original taxable transfer that created or authorized the creation of the power. If the transfer is for the life of an income beneficiary with succeeding interests to other persons, both the life tenant and the other remaindermen, whether their interests are vested or contingent, must disclaim no later than 9 months after the original taxable transfer. In the case of a remainder interest in property which an executor elects to treat as qualified terminable interest property under section 2056(b)(7), the remainderman must disclaim within 9 months of the transfer creating the interest, rather than 9 months from the date such interest is subject to tax under section

2044 or 2519. A person who receives an interest in property as the result of a qualified disclaimer of the interest must disclaim the previously disclaimed interest no later than 9 months after the date of the taxable transfer creating the interest in the preceding disclaimant. Thus, if A were to make a qualified disclaimer of a specific bequest and as a result of the qualified disclaimer the property passed as part of the residue, the beneficiary of the residue could make a qualified disclaimer no later than 9 months after the date of the testator's death. See paragraph (d)(3) of this section for the time limitation rule with reference to recipients who are under 21 years of age.

§ 25.2518-2(c)(5) ex. 1

Example (1). On May 13, 1978, in a transfer which constitutes a completed gift for Federal gift tax purposes, A creates a trust in which B is given a lifetime interest in the income from the trust. B is also given a nongeneral testamentary power of appointment over the corpus of the trust. The power of appointment may be exercised in favor of any of the issue of A and B. If there are no surviving issue at B's death or if the power is not exercised, the corpus is to pass to E. On May 13, 1978, A and B have two surviving children, C and D. If A, B, C or D wishes to make a qualified disclaimer, the disclaimer must be made no later than 9 months after May 13, 1978.

Supreme Court, U.S.
FILED
MAY 24 1991
OFFICE OF THE CLERK

(2)

No. 90-1503

In the Supreme Court of the United States

OCTOBER TERM, 1990

JOHN G. ORDWAY, JR. and MARGARET M. ORDWAY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

KENNETH W. STARR
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SHIRLEY D. PETERSON
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72p

QUESTION PRESENTED

Whether petitioner's partial disclaimer in 1979 of a vested remainder interest in an inter vivos trust created by his grandfather in 1917 was a transfer subject to the federal gift tax.

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In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1503

JOHN G. ORDWAY, JR. and MARGARET M. ORDWAY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 908 F.2d 890. Rehearing was denied without opinion (Pet. App. 27a-28a). The memorandum opinion of the district court (Pet. App. 15a-24a) is unofficially reported at 89-1 U.S.T.C. (CCH) ¶ 13,802.

JURISDICTION

The judgment of the court of appeals was entered on August 10, 1990. The order denying a petition for rehearing was entered on November 1, 1990 (Pet. App. 27a-28a). An extension of time to and including March 27, 1991, for filing a petition for a writ of certiorari was granted by Justice

Kennedy on January 9, 1991. The petition was filed on March 27, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The relevant portions of Sections 2501(a)(1) and 2511(a) of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at the Appendix, *infra*, 1a. The relevant portions of Section 25.2511-1(c) of the Treasury Regulations on Gift Tax (26 C.F.R.) are set forth at the Appendix, *infra*, 1a-3a.

STATEMENT

1. Lucius P. Ordway, the grandfather of petitioner John G. Ordway, Jr.,[1] established an irrevocable inter vivos trust on January 16, 1917. The term of the trust was for the lives of Lucius Ordway's wife and five children, and the income generated by the trust was paid to them. The trust provided that, upon the death of the last surviving life beneficiary, the corpus of the trust was to be distributed to Lucius Ordway's grandchildren, per capita. The trust further provided that, if any of Lucius Ordway's grandchildren died leaving issue prior to the termination of the trust, that grandchild's share of the corpus was to be distributed to his or her issue, per stirpes (Pet. App. 2a).

At his birth on November 29, 1922, petitioner thus acquired a contingent remainder interest in the trust. Petitioner became aware of his interest in the trust in 1941, when he was nineteen years old. Petitioner's interest vested on June 27, 1979, upon the death of Lucius Ordway's last surviving

---

[1] Margaret Ordway is a party hereto by virtue of having consented, pursuant to Section 2513 of the Code, to have her husband's gifts considered as made one-half by each of them. In the interest of clarity, however, we will refer to John G. Ordway, Jr., as petitioner, inasmuch as it is his trust interest and his disclaimer that underlie this litigation.

child. On August 23, 1979, petitioner filed a valid, partial disclaimer of his interest in the trust corpus under Minnesota law. By virtue of the disclaimer, petitioner's three children received the disclaimed portion of his interest in the trust (Pet. App. 2a).

Petitioner filed a gift tax return with the Internal Revenue Service disclosing the 1979 disclaimer, but taking the position that the disclaimer was not a transfer subject to the gift tax. During an audit of that return, petitioner filed an amended return which treated the disclaimer as a taxable transfer under the gift tax provisions. Petitioner paid the tax shown to be due on his amended return. The Internal Revenue Service later assessed deficiencies and interest, which petitioner paid (Pet. App. 3a).

On March 10, 1980, petitioner made a gift of stock that was unrelated to the 1979 disclaimer. Petitioner filed gift tax returns for 1980, but the Commissioner determined that, because of the recharacterization of the 1979 disclaimer as a gift, there was a deficiency for 1980. Petitioner paid the gift tax due, and also paid the deficiencies determined by the Commissioner. Petitioner filed timely claims for refund of the taxes and interest paid for 1979 and 1980, which the Commissioner disallowed.

2. On March 16, 1987, petitioners filed suit in district court seeking a refund of the taxes and interest paid (Pet. App. 3a-4a). Both parties filed motions for summary judgment. The government contended that this Court's decision in *Jewett* v. *Commissioner*, 455 U.S. 305 (1982), controls the outcome of this case. *Jewett* established that a disclaimer is subject to the gift tax unless it falls within the narrow exception in Section 25.2511-1(c) of the Treasury Regulations on Gift Tax (26 C.F.R. 25.2511-1(c)), which provides that a disclaimer is not subject to tax if it is effective under local law and is made "within a reasonable time after knowledge of the existence of the transfer." *Ibid*. This Court

held in *Jewett* that the term "transfer" as used in the regulations for measuring the timeliness of the disclaimer refers to the original creation of the interest, rather than the subsequent vesting of that interest. 455 U.S. at 310. In *Jewett*, the trust was established by the taxpayer's grandmother in 1939, but the taxpayer did not disclaim his contingent remainder interest until 1972. The Court held that the disclaimer, filed 33 years after the interest was created, was untimely. Relying on *Jewett* in this case, the government thus contended that petitioner's disclaimer was not timely because it was made 38 years after he learned of his interest in the trust (Pet. App. 19a-20a).

Petitioner argued that this case is distinguishable from *Jewett* because the trust established by petitioner's grandfather had been created in 1917, prior to the enactment of the gift tax in 1932. Petitioner also argued that applying the gift tax to the partial disclaimer would constitute an improper retroactive application of the gift tax to the original 1917 transfer in trust (Pet. App. 19a-22a).

The district court granted petitioner's motion for summary judgment, holding that the disclaimer in 1979 did not constitute a transfer subject to the gift tax. The court found this case to be distinguishable from *Jewett* because the trust was created in 1917, prior to the enactment of the gift tax (Pet. App. 25a-26a).

3. The court of appeals reversed, with one judge dissenting. The court concluded that petitioner's disclaimer of his trust interest was not made within a "reasonable time" under this Court's opinion in *Jewett*, and that the disclaimer was therefore a taxable gift (Pet. App. 11a-12a).

ARGUMENT

The court of appeals correctly held that the partial disclaimer in 1979 of an interest in a trust created in 1917

is properly subject to the federal gift tax. The result in this case is a direct application of this Court's decision in *Jewett* v. *Commissioner*, 455 U.S. 305 (1982). The decision of the court of appeals is not in conflict with the decision of any other circuit. Further review by this Court is therefore not warranted.

1. Sections 2501(a) and 2511(a) of the Internal Revenue Code impose a tax "on the transfer of property by gift," whether the transfer is in trust or otherwise, and whether the gift is "direct or indirect." 26 U.S.C. 2501(a), 2511(a). When a person disclaims an interest in property, that person reduces the size of his taxable estate, directs the passing of the property to others, controls its enjoyment, and confers a gratuitous benefit upon "the natural objects of his bounty." *Jewett* v. *Commissioner*, 455 U.S. at 319 (quoting *Jewett* v. *Commissioner*, 70 T.C. 430, 438 (1978)). This Court held that indirect transfers of property by means of a disclaimer are therefore properly treated as taxable gifts subject to the federal gift tax. 455 U.S. at 318.

In 1958, 21 years before the disclaimer at issue in this case, the Internal Revenue Service issued Section 25.2511-1(c) of the Treasury Regulations on Gift Tax, which provides a narrow exception to the gift tax for a limited category of disclaimers.[2] The regulation establishes two separate requirements for a disclaimer to qualify as a nontaxable transfer. First, the disclaimer must be unqualified, unequivocal, and effective under local law. Second, the disclaimer must be made "within a reasonable time" after a person learns of his rights in the property. Treas. Reg. § 25.2511-1(c)(2). In *Jewett*, this Court held that the "reasonable time" requirement is measured from the date of knowledge of the transfer which created the disclaimed

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[2] This regulation applies to all disclaimers made after December 31, 1954. See 23 Fed. Reg. 8904-8905 (1958).

interest, as opposed to the date on which that interest either vested or became possessory. 455 U.S. at 318.

The court of appeals was therefore unquestionably correct in holding (Pet. App. 10a) that the disclaimer that occurred in this case—38 years after petitioner learned of his rights in the property—was not made within a "reasonable time" under this Court's holding in *Jewett*. As the court observed, the 38-year delay in this case "is some twelve to fourteen years over the twenty-four year period which the Supreme Court found unacceptable in *Jewett*." *Ibid*. The disclaimer therefore did not qualify as a non-taxable transfer under the regulation. *Ibid*.

2. Petitioner contends (Pet. 9-15), however, that a gift tax cannot be imposed on a disclaimer of a property interest that was created prior to the enactment of the federal gift tax in 1932. Petitioner argues that the "transfer" at issue in this case was made by Lucius Ordway in 1917, well before the passage in 1932 of the gift tax, and therefore cannot constitutionally be subject to that tax.

Petitioner's argument misperceives the transaction to which the gift tax is being applied. It is the 1979 disclaimer, not the 1917 transfer in trust, that constitutes the taxable event. The Internal Revenue Service has not attempted to impose a gift tax on the original transfer in trust made by petitioner's grandfather in 1917. That transfer was clearly not subject to the gift tax. The 1917 transfer is relevant *only* insofar as it establishes the date from which the petitioner has a "reasonable time" to disclaim an interest in property under the regulation. When petitioner obtained a contingent remainder interest in the trust upon his birth in 1922, that remainder was unquestionably free of any gift tax consequences insofar as his grandfather was concerned.

Petitioner's partial disclaimer, however, which was executed in 1979, is a wholly separate matter. Transfers of property by gift, whether "direct or indirect," are properly

subject to tax. *Jewett* v. *Commissioner*, 455 U.S. at 309 (citing 26 U.S.C. 2511(a)). The regulations that are specifically applicable to indirect transfers effected by a disclaimer have been in effect since 1958. See 455 U.S. at 312. It is the untimely disclaimer of the property interest in 1979—which occurred more than twenty years after adoption of the applicable regulation—that constituted the gift creating gift tax liability. As this Court stated in *Jewett* in rejecting a similar claim that a tax on disclaimers gives an improper "retroactive" effect to the gift tax (455 U.S. at 317 (footnote omitted)):[3]

> Petitioner also argues that it is unfair to apply the 1958 Regulation "retroactively" to an interest that had been created previously; petitioner asserts that, by the time the Regulation was adopted, it was already too late—according to the Commissioner's view—to disclaim the interest. The argument lacks merit. It is based on an assumption that petitioner had a "right" to renounce the interest without tax consequences that was "taken away" by the 1958 Regulation. Petitioner never had such a right. * * * The 1958 Regulation was adopted well in advance of the disclaimers in this case; we see no "retroactivity" problem.[4]

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[3] In the footnote omitted from this passage, the Court noted that the petitioner's argument in *Jewett* regarding his ability to make a timely disclaimer "[w]ould have more appeal had he attempted to renounce the interest immediately after the adoption of the 1958 Regulation, rather than some 14 years later." 455 U.S. at 317 n.20.

[4] Petitioner also contends (Pet. 12-13) that the omitted sentence from the textual quotation—which states that "petitioner does not argue that taxation of the disclaimers is inconsistent with the statutory provisions imposing a gift tax, which were enacted long before petitioner's interest in the trust was created"—demonstrates that disclaimed interests created prior to 1932 are not subject to gift tax. Since the interest at issue in *Jewett* was created in 1939, however, the sentence upon which peti-

3. In 1976, Congress enacted Section 2518 of the Internal Revenue Code, which altered the "reasonable time" requirement of the regulation. Under the new statute, a "qualified disclaimer" must be made within nine months after the later of the date on which the transfer creating the interest is made or the day on which the person making the disclaimer attains age 21. 26 U.S.C. 2518(b)(2). Section 2518 is not directly involved in this case since it applies only to disclaimers of interests that were created after December 31, 1976 (Treas. Reg. § 25.2518-1(a)) and petitioner's interest was created upon his birth in 1922.

The preexisting disclaimer regulation (Treas. Reg. § 25.2511-1(c)) was amended on August 7, 1986, however, to conform to the regulations promulgated under the new Section 2518 of the Code. See T.D. 8095, 1986-2 C.B. 160. Section 25.2511-1(c)(2) therefore now provides in pertinent part that:

> In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law.

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tioner relies was merely descriptive. The taxable event in the present case is the 1979 disclaimer, not the 1917 transfer in trust, and the Court's analysis in *Jewett* is directly applicable to this case.

In an attempt to bolster their contention that the gift tax applies only to disclaimers of interests that were created after the enactment of the gift tax in 1932, petitioner contends (Pet. 16-21) that the use of the word "taxable" in the phrase in the amended regulation referring to "taxable transfers creating an interest in the person disclaiming made before January 1, 1977" demonstrates that the gift tax applies only to disclaimed interests created after 1932. Petitioner claims that Lucius Ordway's original transfer, which created the interest that petitioner disclaimed in 1979, was not "taxable" because it was made in 1917, before the gift tax existed. Petitioner therefore concludes (Pet. 18) that his disclaimer falls outside the scope of the amended regulation.

As the court of appeals recognized (Pet. App. 9a), however, the term "taxable transfer" in the amended regulation merely refers to a transfer that is a completed gift for purposes of the gift tax, whether or not a gift tax was actually imposed. See Treas. Reg. § 25.2518-2(c)(3) ("With respect to inter vivos transfers, a taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift."). As petitioner appears to recognize (Pet. 18 n.19), annual gifts of up to $10,000 per donee (which are excluded from the gift tax under Section 2503(b) of the Code) nevertheless are treated as "taxable transfers" under the regulation. This interpretation by the Internal Revenue Service of its own regulation is entitled to considerable deference. See *Bowles* v. *Seminole Rock Co.*, 325 U.S. 410, 413-414 (1945).[5]

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[5] Contrary to petitioners' contentions (Pet. 19-21), there is nothing in the majority's opinion which "invites taxpayer abuse" or "destroys uniformity" in the disclaimer area. The potential abuses identified by petitioners are specifically addressed by the regulations. For example, with respect to potential abuse involving nongeneral powers of appointment, the regulation provides that "the holder of the power, per-

3. Petitioner acknowledges (Pet. 21) that he did not argue in the courts below that this Court's 1981 decision in *Jewett* should not be applied "retroactively" to tax the partial disclaimer in 1979. Petitioner nonetheless now claims (Pet. 21-26) that the court of appeals should have considered the argument *sua sponte* and should have resolved the question in his favor. Indeed, petitioner now suggests (Pet. 23 n. 22) that the case should be remanded for consideration of the retroactivity question, which petitioner failed to raise below.

The court of appeals can hardly be faulted for failing to consider an argument petitioner failed to raise. It is, for example, the settled practice of this Court as well to refrain from addressing issues not raised in the court of appeals. *EEOC* v. *FLRA*, 476 U.S. 19, 24 (1986) (per curiam). It is, in any event, not difficult to see why the issue was not presented below, for petitioner's retroactivity argument has no merit.

Petitioner became aware of his trust interest in 1941. Yet he waited 38 years, until 1979, to disclaim a portion of the interest. He contends (Pet. 23-26) that this delay was justified because of his reliance on *Keinath* v. *Commissioner*, 480 F.2d 57 (8th Cir. 1973), which held that the "reasonable time" for executing a tax-free disclaimer of a remainder interest did not commence to run until the disclaimed interest became vested and possessory upon the

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missible appointees, or takers in default of appointment must disclaim within a 9-month period after the original taxable transfer that created or authorized the creation of the power." Treas. Reg. § 25.2518-2(c)(3). Similarly, with respect to potential "multiple" disclaimers, the regulation provides that "[a] person who receives an interest in property as the result of a qualified disclaimer of the interest must disclaim the previously disclaimed interest no later than 9 months after the date of the taxable transfer creating the interest in the preceding disclaimant." *Ibid.*

death of the last surviving life tenant. Petitioner broadly claims (Pet. 26) that "[a]t no time prior to his disclaimer was [he] on notice that a failure to disclaim promptly might be at his own peril."

Petitioner's claim of reliance on *Keinath* is insubstantial. *Keinath* was not decided until 1973, fully 32 years after petitioner became aware of his trust interest. Moreover, in 1958, fully 15 years before *Keinath*, the Internal Revenue Service issued its regulation informing all taxpayers that indirect gifts effected by disclaimer were taxable, unless the disclaimers were made "within a reasonable time after knowledge of the existence of the transfer" (Treas. Reg. § 25.2511-1(c)(2)). In 1961, three years after the issuance of the regulation, the Tax Court in *Fuller* v. *Commissioner*, 37 T.C. 147 (1961), applied the regulation to a 1956 disclaimer of a trust interest created in 1931. The court noted in *Fuller* that a disclaimer executed 25 years after the creation of the interest "could not by any stretch of language be said to have been made within a 'reasonable time.'" *Id.* at 155. The next pertinent case was *Keinath* v. *Commissioner*, 58 T.C. 352 (1972), which the Tax Court decided in the Commissioner's favor. The Tax Court judge who decided *Keinath* relied heavily on *Fuller* as precedent. *Id.* at 358-359. It is, of course, true that the Tax Court's decision in *Keinath* was reversed by the Eighth Circuit the following year. In 1978, however, the Internal Revenue Service issued Technical Advice Memorandum 78-29-008 (Apr. 4, 1978), noting its disagreement with *Keinath*, and advising that it would not be followed in disposing of similar cases outside the Eighth Circuit. In that same year, the Tax Court decided *Jewett* in favor of the Commissioner. 70 T.C. 430 (1978). The Ninth Circuit (638 F.2d 93 (1980)) and this Court (455 U.S. 305 (1982)) subsequently affirmed that decision.

From this review, it is evident that petitioner could not have placed any reliance on the *Keinath* decision prior to

1973. But petitioner knew of his interest in the trust some 32 years before *Keinath* was decided. Moreover, prior to the *Keinath* decision, the applicable Treasury Regulation and the Tax Court's decision in *Fuller* placed petitioner on appropriate notice that a timely disclaimer for gift tax purposes had to be made within a reasonable time from knowledge of the creation of the interest. *Keinath* could thus have provided only limited assurance to petitioner between 1973 and 1978 (when the IRS issued its Technical Advice Memorandum) or 1981 (when this Court issued its ruling in *Jewett*). But, by 1973, petitioner had already possessed, for more than thirty years, the effective right to determine who would receive the benefits of his trust interest. This Court held in *Jewett* that the possession of such control over the disposition of property for a period of 24 years was sufficient to disqualify the disclaimer from the gift tax exception. See *Jewett* v. *Commissioner*, 455 U.S. at 319 (quoting *Jewett* v. *Commissioner*, 70 T.C. at 438 (footnote omitted)). The taxpayer in *Jewett* also sought to claim a right to rely upon *Keinath*, which was the only court of appeals decision on the issue prior to *Jewett*. See *Jewett* v. *Commissioner*, 638 F.2d at 95-96, and 455 U.S. at 323-324 (Blackmun, J., dissenting). Nevertheless, this Court determined that such reliance on *Keinath* was misplaced. 455 U.S. at 318 (the Commissioner's consistent interpretation "is entitled to respect").

The decision of the court of appeals in this case thus is merely a proper application of this Court's decision in *Jewett*. There is no conflict among the circuits or other reason to justify further review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2501 (1970). IMPOSITION OF TAX.

(a) *Taxable Transfers.* –

(1) *General rule.* – For the first calendar quarter of calendar year 1971 and each calendar quarter thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar quarter by any individual resident or nonresident.

* * * * *

SEC. 2511. TRANSFERS IN GENERAL.

(a) *Scope.* Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

* * * * *

Treasury Regulations on Gift Tax (26 C.F.R.):

Section 25.2511-1 (1958) *Transfers in General*

* * * * *

(c) The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax. See further § 25.2512-8. Where law governing the administration of the decedent's estate gives a beneficiary, heir, or

next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution in interstate property), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable [*sic*] and effective under the local law. There can be no refusal of ownership of property after its acceptance. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.

* * * * *

Section 25.2511-1(c) (1986) *Transfers in General*

* * * * *

(2) In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or

next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law. There can be no refusal of ownership of property after its acceptance. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.

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Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

Respondent's Opposition misstates Petitioners' legal argument to this Court and largely ignores the issues raised in this case. It succeeds, however, in demonstrating that the scope of the constitutional prohibition against retroactive excise taxation is squarely presented on the facts, and that this case is a thoroughly appropriate vehicle by which to correct the court of appeals' significant break with an important and longstanding line of constitutional authority.

I. PETITIONERS WERE DENIED THEIR CONSTITUTIONAL RIGHT TO BE FREE FROM RETROACTIVE GIFT TAXATION

In order to appraise the worthiness of Petitioners' constitutional claims, it is necessary to sweep away the misconceptions and evasions that fill Respondent's brief, and

recognize the sharply defined legal issues that are acknowledged to be raised in this Petition. Respondent incorrectly states, for example, that this case is controlled by the Court's decision in *Jewett* v. *Commissioner*, 455 U.S. 305 (1982), wrongfully suggesting that Petitioners seek a reversal of that case in order to address their claims. The question, rather, is whether the court of appeals' extension of *Jewett* to the disclaimer of an interest created prior to enactment of the gift tax crossed a boundary of constitutionally prohibited action that has been firmly in place for more than sixty years and endorsed by all three branches of government. Respondent's error is in ignoring completely this history, and with it the constitutional issue presented.

Respondent contends that whether an excise tax is retroactive in the context of a disclaimer is determined *solely* with reference to the date when the disclaimer is made. Opp. 6. This argument is based exclusively upon Respondent's citation to the broad *statutory* and *regulatory* definitions of "gift" as including the act of disclaimer. Opp. 6-7. But Petitioners do not dispute that a disclaimer can be a "gift;" *Jewett* so held. What Respondent has ignored is that there exists a *constitutional* limitation on the temporal operation of gift tax statutes—that in assessing the question of retroactivity there is, in other words, a need to focus not on the date of the disclaimer but on the date when the interest passing as a consequence of the disclaimer was created. Pet. 14. Respondent's extreme position, mirroring that of the court of appeals, properly frames this constitutional issue for resolution by the Court.

Congress (since its first effort to tax gifts was declared unconstitutionally retroactive by this Court) uniformly has recognized that retroactivity in the context of disclaimers must refer to the date when the interest disclaimed was created, not, as Respondent urges, when the disclaimer is made. Pet. 11-12. It has been recognized as

well by this Court in *Jewett* and indeed even by the Government in its arguments to the Court in that case. *Id.* 12-13. This compelling weight of constitutional authority is left unanswered by Respondent.

Respondent is completely silent on the settled constitutional jurisprudence as understood by Congress—the body responsible in the first instance for implementing the prohibition against retroactive gift taxation. As for *Jewett*, Respondent dismisses as "merely descriptive" the Court's explanation (455 U.S. at 317) that the taxpayer had no " 'right' " to disclaim free from tax because the interest disclaimed was created after enactment of the gift tax. Opp. 7-8 n.4. The Court's opinion, however, quite obviously cites the post-gift tax creation of the interest as a principal reason why no "right" to disclaim free of tax existed. Of equal significance is the Government's own brief in *Jewett* (quoted at Pet. 13), which advanced this position and which the Court adopted. The Government's linkage of a pre-gift tax transfer and a "right" to disclaim free from tax is a model of clarity and persuasiveness, and flatly contrary to Respondent's position in this case. Respondent, however, has chosen to ignore this language as well.

Retroactive excise taxation is prohibited by the Due Process Clause to preserve the legitimate and settled expectations of donors who part with property voluntarily and irrevocably. *See Welch* v. *Henry*, 305 U.S. 134, 147 (1938). Here, for example, a trust was established in 1917, fifteen years prior to enactment of the gift tax. The transfer into trust was not then taxable, nor was the creation of any of the vested and contingent rights that sprang therefrom. Included among those rights was that of a beneficiary to disclaim causing property to be transferred under the trust to an alternate beneficiary designated by the donor. It is of no moment that Petitioner did not disclaim until his interest vested in 1979, a fact

Respondent repeats time and time again. The "delay" in disclaiming is really no delay at all, but merely the exercise of a right guaranteed by the Constitution. When the donor relinquished control of his property in 1917, the exercise of that right to disclaim in conformity with state law was understood to be free from taxation.[1] So must it remain.[2]

II. A CONSTITUTIONALLY TAX FREE 1917 TRANSFER INTO TRUST CANNOT BE A "TAXABLE TRANSFER"

Wholly apart from the constitutional problems of applying the treasury regulations to the disclaimer in this case, Petitioners argue that the court of appeals improperly determined that the 1917 transfer satisfies the jurisdictional requirement of a "taxable transfer" contained in the amended treasury regulations. Pet. 16-19. Respondent acknowledges (Opp. 6) that the 1917 transfer "cannot constitutionally be subject to [the gift] tax," but maintains (*id.* 9) that it nevertheless can be a "com-

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[1] Respondent attributes to Petitioners the claim that the disclaimer of a pre-gift tax interest may never be subject to federal tax. Opp. 6. This is categorically false. At the time the trust was created (and as remains the case), state law established requirements that must be satisfied for a disclaimer to be effective, including requirements as to when the disclaimer must be made. Pet. 3. If those requirements are not met the disclaimer is not valid, and a gift tax properly may attach. Petitioners' contention, rather, is that neither Congress nor Respondent by regulation may constitutionally superimpose on trust beneficiaries a separate federal disclaimer standard that was not reasonably foreseeable by the donor at the time of the irrevocable transfer. Pet. 6 n.7.

[2] The fairness of this rule is demonstrated by observing that Lucius Ordway in 1917 could have achieved the purposes of his trust in either of two ways: As he did, by the creation of contingent interests subject to disclaimer, or by conferring upon descendants like Petitioner a general power to appoint themselves the beneficiary of the trust corpus, subject to the release of that power. Had Lucius Ordway chosen the latter course, there would be no question but that Petitioner's release of the general power of appointment in 1979 would have been free of tax. *See* Pet. 12 n.12.

pleted gift for purposes of the gift tax," thus satisfying the regulatory requirement. Respondent then attempts to shield its improbable construction from review with a vague claim that it is entitled to "considerable deference" in interpreting the treasury regulation. *Ibid.*

There is no dispute that agencies are entitled to deference in construing ambiguous regulations which they administer. The rule is well settled, however, that an agency may not interpret its own regulations to conflict with the regulations' "plain language." *Gardebring* v. *Jenkins*, 485 U.S. 415, 430 (1988); *Bowles* v. *Seminole Rock and Sand Co.*, 325 U.S. 410, 414 (1945). Such is the case here.

On its face, a "taxable transfer" cannot embrace a constitutionally tax free transfer except through an act of acrobatic circularity, one which begs the question whether a transfer is a "completed gift for Federal gift tax purposes." *See* Treas. Reg. § 25.2518-2(c)(3). Moreover, Treasury Regulations §§ 25.2511-2(a) and (b) make unequivocally clear that gifts completed for gift tax purposes can include only those transfers which are subject to the gift tax.[3] Since, as both parties agree, the 1917 transfer is not subject to the gift tax, it cannot be a "completed gift for Federal gift tax purposes." And the fact that the amended regulation's "taxable transfer" requirement may be met "regardless of whether a gift tax is imposed on the completed gift" (Opp. 9) can-

[3] Treasury Regulations §§ 25.2511-2(a) and (b), which define when a gift has been completed, provide in pertinent part that: "The gift tax is not imposed upon the receipt of the property by the donee . . . . On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable. . . . As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete."

not expand the scope of that regulation to reach a transfer which—in conformity with constitutional limitations—the regulation was never intended to embrace. Respondent's construction reads the word "taxable" out of the phrase "taxable transfer," an error compounded by the fact that the regulation was amended in 1986 specifically to add that word. *See* Pet. 7 n.8.

Petitioners demonstrated that the court of appeals' construction of the treasury regulations governing disclaimers would promote taxpayer abuse. Pet. 19-21. Respondent disagrees, citing examples in the regulations that correctly state what the regulations provide, but that happen to be wholly at odds with what the court of appeals said. Opp. 9-10 n.5. Specifically, the court concluded "that for purposes of measuring time . . . a taxable transfer occurs *whenever there happens* 'any transaction in which an interest in property is gratuitously passed or conferred upon another.'" Pet. App. 9a (citation omitted) (emphasis added). It is this overly broad interpretation, which effectively removes the limitations of Treasury Regulation § 25.2518-2(c)(3), that causes the decision of the court of appeals to be a significant and potentially very disruptive departure from settled law. Respondent has said nothing to lessen that concern, or to justify construing an unambiguous regulation contrary to its plain meaning to achieve an unconstitutional result.

III. THE COURT OF APPEALS' IMPROPER RETROACTIVE APPLICATION OF *JEWETT* v. *COMMISSIONER* IS PROPERLY BEFORE THE COURT

Respondent answers Petitioners' claims that the court of appeals improperly gave *Jewett* retroactive application by throwing up a series of imaginary procedural roadblocks to review by this Court. It is simply not true that Petitioners "acknowledge" that they did not urge in the court below the nonretroactivity of *Jewett*. Opp. 10. On the contrary, Petitioners' justifiable reliance upon

the decision in *Keinath* v. *Commissioner*, 480 F.2d 57 (8th Cir. 1973), and the unconstitutionality of applying *Jewett* to them, has been a primary contention throughout. *See* Pet. 21-22. And it clearly is not the case that this Court is foreclosed from considering the manifest injustice visited by retroactive application of the 1982 *Jewett* decision to a 1979 disclaimer—an issue addressed fully by the dissent in the court of appeals.[4] Pet. 22-23; *id.* App. 13a-14a.

Respondent's denial that Petitioner exercised reasonable reliance on the *Keinath* rule in declining to disclaim prior to 1979 similarly misstates the governing law. Respondent asks: How could Petitioner have relied on *Keinath*, which was decided 32 years after he learned of his interest, and 11 years after promulgation of the first disclaimer regulation (Opp. 11)? The answer is that *Keinath* by its own terms merely restated what was universally considered theretofore to have been the governing law.[5] Pet. 24-25; *Keinath*, 480 F.2d at 64. An equally persuasive answer is that the Commissioner of Internal Revenue expressly advised residents of the

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[4] *EEOC* v. *FLRA*, 476 U.S. 19 (1986), the sole authority cited by Respondent in support of its claim of a procedural bar, involved a *statutory* prohibition against judicial review of certain claims and is patently inapposite.

[5] The only case involving the disclaimer regulation prior to *Keinath* was *Fuller* v. *Commissioner*, 37 T.C. 147 (1961), which held that there can be no effective disclaimer of an immediate noncontingent life estate after its acceptance. *See* Pet. App. 21a-22a. No acceptance of any interest at issue here was made by Petitioner. And *Fuller* cannot be considered notice (Opp. 11) that disclaimers of contingent remainder interests were to be effected in any manner other than in accordance with the prevailing common law. Respondent also contends (Opp. 12) that the issue of reasonable reliance upon *Keinath* was rejected by this Court in *Jewett*. The taxpayer in *Jewett*, however, was not an Eighth Circuit resident and made his disclaimer more than six months before *Keinath* was even decided. The reliance issue presented here thus was never before the Court in *Jewett*.

Eighth Circuit (such as Petitioners then were) that he would follow *Keinath* for subsequently-made disclaimers, no matter how long the interest disclaimed had been held. Pet. 24.[6] Respondent's reversal of Petitioners' fortune thus indeed is at the expense of legitimate, legally protectable reliance interests.

CONCLUSION

This case places at risk the disposition of what Respondent does not dispute may be tens of billions of dollars of trust assets, if not more. It involves continuing and significant constitutional issues potentially affecting every taxpayer and the permissible scope of all subsequent legislation involving gift taxation. The Petition for Certiorari should be granted.

Respectfully submitted,

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[6] As late as 1980 the Government continued not to challenge application of the *Keinath* rule to taxpayers situated as Petitioners. *See Cottrell* v. *Commissioner*, 628 F.2d 1127, 1131 (8th Cir. 1980) (en banc).

(4)

No. 90-1503

Supreme Court, U.S.
FILED
JUN 11 1991
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

JOHN G. ORDWAY, JR. and MARGARET M. ORDWAY,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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SUPPLEMENTAL BRIEF FOR PETITIONERS

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SUPPLEMENTAL BRIEF FOR PETITIONERS

Petitioners John G. Ordway, Jr. and Margaret M. Ordway wish to bring to the attention of the Court the June 10, 1991 split decision of the United States Court of Appeals for the Eighth Circuit in *Irvine* v. *United States*, No. 89-5616 MN, Supp. App., *infra*, which addresses issues essentially identical to those presented in this case. In *Irvine*, two judges of the Eighth Circuit, writing separate opinions, reversed a decision of the district court in favor of the taxpayer. A third judge dissented, adopting many of the constitutional, statutory, and regulatory arguments advanced by Petitioners here. The *Irvine* decision demonstrates graphically the need for the important issues presented in this Petition to be resolved by this Court correctly and definitively.

The two separate opinions for reversal pursue different theories. Most pointedly, only the lead opinion adopts the

rationale of the court of appeals in *Ordway* that a "taxable transfer" exists whenever there is "any transaction in which an interest in property is gratuitously passed or conferred upon another." Supp. App., *infra*, SA 8 (citations omitted). This erroneous and dangerous conclusion, which two judges in *Irvine* refused to adopt and which thus is the law of the Eleventh Circuit but not the Eighth Circuit, is one of the issues presented for review in this Petition. See Pet. at 16.

The vigorous dissent of Judge Bowman, citing this Court's history of striking down on constitutional grounds gift taxes found to be retroactive, concludes that Congress could not and did not intend to tax the disclaimers of interests created before passage of the taxing statute. The dissent criticizes as "stunning" the distortion of the term "taxable transfer" effected by the panel's holding, concluding it is inconsistent with both congressional intent and the applicable regulation's plain language: "Once the pretense that by some mysterious alchemy the treasury regulations have transformed the non-taxable 1917 transfer into a taxable event is stripped away, the government is left without any authority (other than *Ordway*, which cannot withstand critical analysis) to support its position." Supp. App., *infra*, SA 18.

The *Irvine* decision has not clarified but has unsettled further an important aspect of estate and gift taxation for which certainty is essential, and upon which generations of taxpayers have relied. And it has generated a conflict over the meaning of the term "taxable transfer" that may enable taxpayers to avoid not only the limitations imposed by the statute but the holding of this Court in *Jewett* v. *Commissioner*, 455 U.S. 305 (1982), as well. *See* Pet. at 19-21. Eight federal judges have reviewed the issues presented in this Petition, splitting four-to-four. The two court of appeals decisions alone have generated

five separate opinions. The Petition for Certiorari should be granted.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

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UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 89-5616

JOHN O. IRVINE and FIRST TRUST NATIONAL ASSOCIATION, a national banking corporation, as co-personal representatives of the Estate of SALLY O. IRVINE,

Appellees,

v.

UNITED STATES OF AMERICA,

Appellant.

Appeal from the United States District Court
for the District of Minnesota

Submitted: September 10, 1991

Filed: June 10, 1991

Before McMILLIAN, Circuit Judge, BRIGHT, Senior Circuit Judge, and BOWMAN, Circuit Judge.

McMILLIAN, Circuit Judge.

The United States (hereinafter the government) appeals from a final order entered in the District Court

for the District of Minnesota granting summary judgment in favor of John O. Irvine and First Trust National Association (hereinafter taxpayers) as the personal representatives of the Estate of Sally Ordway Irvine (hereinafter Mrs. Irvine) and directing the government to refund federal gift taxes and interest paid by Mrs. Irvine for the third quarter of 1979 and the third quarter of 1980. For reversal, the government argues the district court erred in holding that Mrs. Irvine's partial disclaimer in 1979 of a remainder interest in a trust created by her grandfather in 1917 was not subject to federal gift tax. For the reasons discussed below, we agree with the government. Accordingly, we reverse the order of the district court and remand the case to the district court for further proceedings.

BACKGROUND FACTS

The underlying facts are not disputed. Mrs. Irvine was a granddaughter of Lucius P. Ordway. In January 1917 Lucius P. Ordway established an irrevocable inter vivos trust. The trust income was to be paid to Ordway's wife, Jessie G. Ordway, and their five children for their lives. The trust also provided that if any of Ordway's children died before the termination of the trust, that child's issue and his or her surviving spouse, as long as he or she remained unmarried, would receive the child's share of the trust income. On the death of the last surviving life beneficiary, the trust corpus was to be distributed to the grandchildren, per capita. If any of the grandchildren died with issue before the termination of the trust, that grandchild's share would be distributed to his or her surviving issue, per stirpes. Mrs. Irvine became aware of her interest in the trust when she turned 21 in 1931.

In June 1979 Katharine G. Ordway, who was Mrs. Irvine's aunt and the last surviving child of Lucius P. Ordway, died unmarried, and the trust terminated.

Twelve Ordway grandchildren, including Mrs. Irvine, were living at the time of Katharine G. Ordway's death. Because one grandchild had died with issue, the trust corpus was to be divided into thirteen shares. On August 17, 1979, about two months after Katharine G. Ordway's death but 48 years after Mrs. Irvine had become aware of her interest in the trust, Mrs. Irvine disclaimed part of her share in the trust corpus. It is undisputed that Mrs. Irvine's partial disclaimer was valid under Minnesota law. Minn. Stat. Ann. § 501.211 (West 1989) (valid disclaimer if filed in Minnesota district court within six months of event which causes disclaimant to be finally ascertained and interest indefeasibly fixed) (repealed by 1989 Minn. Laws, ch. 340, art. I, § 70 (codified at Minn. Stat. Ann. § 501B.86 (West 1990) (within nine months) (effective Jan. 1, 1990)). By virtue of the partial disclaimer, Mrs. Irvine's five children received, per stirpes, the disclaimed portion of her share of the trust corpus.

In November 1979 Mrs. Irvine filed a third quarter gift tax return reporting the disclaimer but stating that the partial disclaimer was not a transfer subject to the gift tax. Following an IRS audit of that return, Mrs. Irvine filed an amended gift tax return in March 1982, reported the partial disclaimer as a taxable transfer, and paid the gift tax due, $7,468,671.00. In April 1982 she paid an additional $2,086,627.51 in accrued interest on the deficiency. In the meantime, in August 1980, Mrs. Irvine had created a charitable remainder annuity trust and transferred $120,000.00 to the First Trust Co. of St. Paul as trustee. This transfer was a taxable gift of the income interest under the annuity (determined to be $75,337.00 under the applicable Treasury regulations). In November 1980 Mrs. Irvine filed a 1980 third quarter gift tax return reporting the transfer to the trust company as a taxable gift. Because the tax due on the transfer, $15,427.62, was offset by Mrs. Irvine's re-

maining unified credit against estate and gift taxes, the 1980 third quarter gift tax return showed no gift tax due. In June 1982 the IRS notified Mrs. Irvine that because the adjustments made to her 1979 third quarter gift tax return on account of the partial disclaimer had reduced the amount of unified credit available to her by $38,000.00, she owed an additional $44,035.90 in gift taxes for the transfer to the annuity trust. In September 1982 Mrs. Irvine paid the additional taxes due and accrued interest ($10,959.51).

In 1984 Mrs. Irvine filed timely claims for refunds of the gift taxes and interest paid. In March 1987 the IRS disallowed the refund claims. Mrs. Irvine died on November 1, 1987.

PROCEEDINGS IN DISTRICT COURT

In February 1988 taxpayers, as the personal representatives of Mrs. Irvine's estate, filed the present action against the government in federal district court seeking a refund of the gift taxes and interest paid. 26 U.S.C. § 7422; 28 U.S.C. § 1346(a)(1). Taxpayers also alleged that the value of the disclaimed remainder interest had been overstated in the 1979 third quarter gift tax return. The parties filed cross-motions for summary judgment. The government argued that the 1979 partial disclaimer was a transfer subject to federal gift tax because it had not been made "within a reasonable time after knowledge of the existence of the transfer" as required by Treasury Regulation § 25.2511-1(c). The government cited in support *Jewett v. Commissioner*, 455 U.S. 305 (1982) (*Jewett*). Taxpayers disagreed and argued that the gift tax did not apply because the Ordway trust predated the enactment of the gift tax in 1932 and the gift tax applies prospectively only, 26 U.S.C. § 1000. Taxpayers argued that *Jewett* was distinguishable from the present case because the trust in *Jewett* had been established in 1939, well after the enactment of the gift tax.

Taxpayers argued in the alternative that *Jewett* had been wrongly decided. Following a hearing on the cross-motions for summary judgment, the district court held that the 1979 partial disclaimer was not a taxable transfer and granted summary judgment in favor of taxpayers. The district court agreed with taxpayers' argument that the gift tax could not be applied retroactively to tax pre-1932 transfers. Slip op. at 8. The district court distinguished *Jewett* because that case involved a 1939 transfer and thus did not involve any question of retroactive application. *Id., citing Ordway v. United States*, No. 87-81877-CIV-TES (S.D. Fla. Mar. 13, 1989), *rev'd*, 908 F.2d 890 (11th Cir. 1990) (*Ordway*), *petition for cert. filed*, 59 U.S.L.W. 3687 (U.S. Mar. 27, 1991) (No. 90-1503).[1] The district court further noted that Mrs. Irvine's remainder interest remained contingent until the death of her aunt in 1979. Slip op at 9-10. The district court directed the government to refund the gift taxes and interest paid for both the third quarter of 1979 and 1980 because the reduction in the unified credit at issue in the 1980 return had been premised upon the invalidity of the 1979 partial disclaimer. This appeal followed.

STANDARD OF REVIEW

We review de novo the district court's decision to grant summary judgment. Summary judgment is proper when there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *see, e.g., McCuen v. Polk County*, 893 F.2d 172, 173 (8th Cir. 1990). In the present case, the relevant facts are not disputed. The issue on appeal is a legal one—whether Mrs. Irvine's partial disclaimer in 1979 of her remainder interest in

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[1] The district court did not of course have the benefit of the appellate opinion in *Ordway v. United States* at the time it decided the present case in September 1989. The Eleventh Circuit did not decide *Ordway v. United States* until August 1990.

a trust created in 1917 was a transfer subject to the federal gift tax.

APPLICABILITY OF GIFT TAX TO INTEREST CREATED BEFORE 1932

"Federal gift tax is imposed 'on the transfer of property by gift.'" *McDonald v. Commissioner*, 853 F.2d 1494, 1499 (8th Cir. 1988) (*McDonald*) (citing 28 U.S.C. § 2501(a)(1)), *cert. denied*, 490 U.S. 1005 (1989). "The scope of this tax is broad, applying 'whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.'" *McDonald*, 853 F.2d at 1499, *citing* 26 U.S.C. § 2511(a). "A trust beneficiary's refusal to accept ownership of property may constitute an indirect gift to a successor in interest subject to federal gift tax liability." *Jewett*, 455 U.S. at 306. "Under Treasury Regulation 26 C.F.R. § 25.2511-1(c), however, such a refusal is not subject to tax if it is effective under local law and made 'within a reasonable time after knowledge of the existence of the transfer.'" *Id.* "The effect of these disclaimer provisions is to collapse the entire transaction into a single transfer from the original owner to the ultimate recipient, thereby ignoring the gift tax consequences of the intermediate disclaimer." *McDonald*, 853 F.2d at 1499, *citing Kennedy v. Commissioner*, 804 F.2d 1332, 1334 (7th Cir. 1986).

The government argues that retroactive application of the gift tax is not the real issue because it seeks to impose the gift tax on the 1979 partial disclaimer, not the inter vivos transfer that created the trust in 1917, and that the present case cannot be meaningfully distinguished from *Jewett*. In *Ordway* the Eleventh Circuit agreed with the government's argument and held that the gift tax did apply to the disclaimer of an interest created before its enactment in 1932. 908 F.2d at 893-95. The facts in the present case and *Ordway* are identical, ex-

cept that the disclaiming individual in *Ordway* was Mrs. Irvine's brother. We agree with the Eleventh Circuit's analysis and accordingly hold that gift tax does apply to the disclaimer of an interest created before 1932.

We agree with the Eleventh Circuit that the fact that the creation of the Ordway trust in 1917 pre-dated the enactment of the federal gift tax in 1932 is not dispositive. *Ordway*, 908 F.2d at 893. Although Congress first passed a federal gift tax in 1924, the Supreme Court held it was unconstitutional because it imposed a tax on transfers made before the date of the act. *See id.* (citations omitted). For this reason, the first valid gift tax statute, passed in 1932, expressly provided that "[t]he tax shall not apply to a transfer made on or before the date of the enactment of this Act." Revenue Act of 1932, ch. 209, § 501(b), 47 Stat. 169. In the present case, as in *Ordway*, the government does not seek to tax the transfers that created the Ordway trust in 1917; it seeks to tax Mrs. Irvine's partial disclaimer in 1979 of her remainder interest in the trust, an indirect transfer which occurred well after both the enactment of the gift tax in 1932 and Treasury Regulation § 25.2511-1(c), which was originally promulgated in 1958.

TAXABLE TRANSFER

Retroactivity is also implicated in another aspect of the present case. As promulgated in 1958, Treasury Regulation § 25.2511-1(c) provided in part that "a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law." Subsequently, in 1976, Congress enacted § 2518 of the Internal Revenue Code, providing that a "qualified" disclaimer of any interest in property would not be treated as a taxable transfer but "as if the interest had never been transferred to [the disclaimant at

all]," and replacing the "reasonable time" requirement with the requirement that "qualified" disclaimers must be made within nine months of the later of either the transfer creating the disclaimed interest or the disclaimant's twenty-first birthday. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009(b)(1), 90 Stat. 1893 (*codified at* 26 U.S.C. § 2518(b)). However, the "qualified" disclaimer provision and the specific time limits apply only to interests created after December 31, 1976, the effective date of the act. *See* Treasury Regulation § 25.2518-1(a). Treasury Regulation § 25.2511-1(c) was amended in 1986, and § 25.2511-1(c)(2) (emphasis added) now provides in part that

> [i]n the case of *taxable transfers* creating an interest in the person disclaiming made before January 1, 1977, . . . a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under local law.

Taxpayers argue § 25.2511-1(c)(2) cannot apply to Mrs. Irvine's partial disclaimer because her remainder interest was not created by a "taxable transfer." Taxpayers argue that the creation of the Ordway trust could not have been a "taxable transfer" because, as noted above, there was no gift tax when the Ordway trust was created in 1917. We disagree because Treasury Regulation § 25.2518-2(c)(3) provides that "[w]ith respect to inter vivos transfers, a taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift." Thus, a "taxable transfer" occurs whenever there is " 'any transaction in which an interest in property is gratuitously passed or conferred upon another,' even if that transaction was not subject to the gift tax." *Ordway*, 908 F.2d at 895, *citing* 26 C.F.R. § 25.2511[-1](c)(1). We agree with this interpretation and hold that

the term "taxable transfer" in Treasury Regulation § 25.2511-1(c)(2) can refer to a transfer before the enactment of the gift tax.

DISCLAIMER WITHIN A REASONABLE TIME

Because the interest disclaimed by Mrs. Irvine was created by a taxable transfer before January 1, 1977, the disclaimer is subject to gift tax unless it was valid under state law and was "made within a reasonable time after knowledge of the existence of the transfer." It is undisputed that the disclaimer was valid under Minnesota law. What is disputed is whether the disclaimer was made within a reasonable time. This issue is a familiar one. *See Cottrell v. Commissioner*, 628 F.2d 1127 (8th Cir. 1980) (banc) (*Cottrell*); *Keinath v. Commissioner*, 480 F.2d 57 (8th Cir. 1973) (*Keinath*), *overruled by Jewett v. Commissioner*, 455 U.S. 305 (1982; *cf. McDonald*, 853 F.2d 1494 (joint tenancy). The government argues that the disclaimer was not "made within a reasonable time after knowledge of the existence of the transfer" because Mrs. Irvine did not disclaim her remainder interest until 1979, some 48 years after she learned of its existence. The government argues that, under *Jewett*, the "reasonable time" during which Mrs. Irvine could have made a disclaimer began to run in 1931, when Mrs. Irvine learned of her remainder interest, and not in 1979, when her interest vested upon the death of the last life beneficiary. We agree.

In *Jewett* the taxpayer's grandmother died in 1939, leaving the bulk of her substantial estate in a testamentary trust. Under the terms of the trust, the trust income was payable to her husband for life and thereafter to the taxpayer's parents. Upon the death of the surviving parent, the trust was to be divided equally among her grandchildren then living or, if any grandchild had died, to that granchild's child or children. In 1972, some 33 years after the creation of the trust and when the tax-

payer's mother, who was one of the life beneficiaries, was still alive, the taxpayer disclaimed his interest in the trust. The taxpayer argued that the word "transfer" in the Treasury regulation referred to the vesting or distribution of the property and that the "reasonable time" during which he could make a disclaimer did not begin to run until that interest vested upon the death of the last surviving life tenant. *See Keinath*, 480 F.2d at 63-64 (holding that time within which disclaimer of vested remainder interest subject to divestiture must be filed begins to run when interest becomes indefeasibly fixed both in quality and quantity, that is, after death of life beneficiary, not testator). The Supreme Court rejected the taxpayer's interpretation and held that the relevant "transfer" referred to in the regulation occurred when the disclaimed interest was created and not later when that interest vested. 455 U.S. at 312, 318-19. The Court held that the taxpayer's disclaimer was not made within a reasonable time of either the creation of the interest, 33 years before, or when he reached the age of majority, 24 years before. *Id.* at 318.

Thus, under *Jewett*, the "reasonable time" during which Mrs. Irvine could have made a disclaimer began to run, at the latest, in 1931 when she became aware of her remainder interest and when she turned 21. Mrs. Irvine's partial disclaimer in 1979, some 48 years later, was clearly too late. This is twice as long as the period which the Supreme Court rejected in *Jewett*. 455 U.S. at 318 (disclaimer made 24 years after age of majority); *see Ordway*, 908 F.2d at 895 (disclaimer made 38 years after knowledge of transfer and 36 years after age of majority).

The district court also based its decision in part on the fact that Mrs. Irvine's remainder interest remained contingent until the death of her aunt, the last life beneficiary, in 1979. However, *Jewett* rejected the argument that "the disclaimer of a contingent remainder is not a

taxable event." 455 U.S. at 317-18 (comparing disclaimer of contingent remainder to exercise of general power of appointment, which is a taxable transfer); *see Ordway*, 908 F.2d at 893 n.4.

RETROACTIVE APPLICATION OF *JEWETT*

Having concluded that the disclaimer of an interest created before the gift tax was enacted is a taxable transfer and that the disclaimer was not made "within a reasonable time," we now face another retroactivity issue, that is, whether it is appropriate to apply the "reasonable time" rule in *Jewett*, which was decided in 1982, to a partial disclaimer made in 1979. In 1979 *Keinath*, which was decided in 1973 and in which the government did not seek certiorari, was the rule in the Eighth Circuit. *Keinath* held that the time within which the disclaimer must be filed begins to run when the remainder interest becomes "indefeasibly fixed in both quality and quantity" and that remainder interests subject to divestment did not become "indefeasibly fixed" until the death of the life beneficiary. 480 F.2d at 63. Thus, under *Keinath*, a disclaimer could be filed within a reasonable time of the death of the life beneficiary. *Id.* In the present case, the last life beneficiary died in June 1979 and Mrs. Irvine filed the partial disclaimer only two months later in August 1979, which was clearly "within a reasonable time" under the *Keinath* rule. In 1980 we affirmed *Keinath* en banc in *Cottrell*, 628 F.2d 1127. It was not until the decision in *Jewett*, some two years later, that the disclaimer rule was changed and *Keinath* was overruled.

As in *Ordway*, 908 F.2d at 896, neither the government nor taxpayers addressed this retroactivity issue on appeal in the present case. In *Ordway* the court decided that because non-retroactivity was an affirmative defense, the taxpayers' failure to raise that defense constituted a waiver and applied *Jewett* retroactively. *Id. But see id.* at 896-97 (Gibson, J., dissenting) (unfair to apply *Jewett*

retroactively to 1979 disclaimer when to do so means taxpayer "will suffer severe tax consequences for failing to do something at a time when the law provided him with no notice that he needed to act"). We also decline to reach this issue.[2]

Accordingly, the order of the district court is reversed and the case is remanded to the district court for further proceedings on the valuation issue.

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[2] It does seem unfair to apply a rule announced in 1982 to a disclaimer which was valid under the applicable law when it was made in 1979. However, to the extent that the unfairness is due to the fact that at the time the new rule was announced, it was already too late to act, we note that a similar retroactivity argument was rejected by the Supreme Court in *Jewett v. Commissioner*, 455 U.S. 305, 317 (1982) (*Jewett*). In *Jewett* the taxpayer argued that it was unfair to apply a 1958 regulation "retroactively" to an interest that had been created in 1939. The taxpayer argued that at the time the regulation was promulgated it was already too late, at least according to the government, to disclaim the interest. The Court held there was no retroactivity problem because the taxpayer's argument was "based on an assumption that [he] had a 'right' to renounce the interest without tax consequences that was 'taken away' by the 1958 Regulation," but the taxpayer "never had such a right." *Id.* The Court further noted that the regulation had been adopted "well in advance" of the disclaimers.

In the present case, the partial disclaimer was valid under the applicable law in effect at that time; however, the Supreme Court subsequently held in *Jewett* that the applicable law, that is, this court's decision in *Keinath v. Commissioner*, 480 F.2d 57 (8th Cir. 1973) (*Keinath*), was incorrect. This is the unfortunate but unavoidable, and in the present case, admittedly costly, consequence of our hierarchical court system. This court is an intermediate appellate court and our decisions are subject to review and to being overruled by the Supreme Court. *Compare Poinier v. Commissioner*, 858 F.2d 917, 918-19 (3d Cir. 1988) (sister's disclaimer held untimely under *Jewett*), *cert. denied*, 490 U.S. 1019 (1989), *with Cottrell v. Commissioner*, 628 F.2d 1127, 1129 (8th Cir. 1980) (banc) (sister's disclaimer held timely under *Keinath*; same family involved in *Poinier v. Commissioner*).

BRIGHT, Senior Circuit Judge, concurring in the result.

I agree that Mrs. Irvine's disclaimer was not valid for federal gift tax purposes. Very simply put, the 1917 gift from Lucius P. Ordway in trust to his wife and heirs constituted a taxable transfer as that term is defined under the applicable gift tax laws and regulations. *See* Treas. Reg. § 25.2518-2(c)(3) (1990). "With respect to inter vivos transfers, a taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift." *Id.* Thus, "taxable transfer", as used in the regulation, merely describes a class of interests to which the regulation applies based upon the nature of the transactions creating them. It is not meant to literally refer solely to transfers in which gift taxes were assessed. Therefore, under Treas. Reg. § 25.2511-1(c)(2) (1990),[1] Mrs. Irvine's remainder interest was subject to the federal gift tax unless her disclaimer, as to the portion here in question, was timely.

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[1] Treas. Reg. § 25.2511-1(c)(2) (1990) reads in pertinent part:

> In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent . . ., a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. . . . There can be no refusal of ownership of property after its acceptance. In the absence of the facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.

Although this regulation read differently at the time Mrs. Irvine made her disclaimer, absent a contrary indication from the Secretary of the Treasury, tax regulations apply retroactively to the year of the Tax Code they interpret, in this case—1976. *See* 26 U.S.C.A. § 7805(b) (West Supp. 1991).

Pursuant to *Jewett v. Commissioner*, 455 U.S. 305 (1982), the time period for Mrs. Irvine to disclaim her interest began to run, at the latest, in 1931 when she was aware of her remainder interest and had reached the age of majority. Clearly, Mrs. Irvine's partial disclaimer, almost fifty years later, was not made within a reasonable time. *See Jewett*, 455 U.S. at 318 (rejecting disclaimer made twenty-four years after reaching age of majority for federal gift tax purposes). Such a late disclaimer will not operate to avoid the application of the federal gift tax laws.

BOWMAN, Circuit Judge, dissenting.

I respectfully dissent. The question on which this case turns is whether Sally Irvine's 1979 partial disclaimer of her contingent remainder interest in an irrevocable trust created in 1917 (when there was no federal gift tax) is a transfer subject to the federal gift tax. The opinion of the Court holds that it is, based on the application of Treasury Regulation § 25.2511-1(c)(2), which provides:

> [i]n the case of *taxable transfers* creating an interest in the person disclaiming made before January 1, 1977 . . . a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law. There can be no refusal of ownership of property after its acceptance.

Treas. Reg. § 25.2511-1(c)(2) (as amended in 1986) (emphasis added). This regulation reflects the unassailable premise that a disclaimer is not subject to the federal gift tax unless the transfer creating the interest disclaimed was a "taxable transfer" for purposes of the Gift Tax Act. I note without surprise that the Treasury Department has not promulgated any regulation dealing

with the refusal to accept ownership of interests created by "nontaxable transfers."

The transfer that created Mrs. Irvine's contingent remainder interest is the irrevocable inter vivos trust created by Lucius P. Ordway in 1917. If the establishment of this trust is indeed a "taxable transfer," even though in 1917 the federal gift tax had not yet been enacted, then Mrs. Irvine's disclaimer of her contingent remainder interest created by the trust would be subject to the federal gift tax unless her disclaimer was timely.[1] But if the creation of her interest by the 1917 Ordway trust is not a "taxable transfer," then the interest validly disclaimed by Mrs. Irvine under Minnesota law passes to her five children unencumbered by the federal gift tax.

It seems fundamental to me that for a transfer to be taxable there must be an applicable tax in existence when the transfer is made. No such federal tax existed on January 16, 1917 when Lucius P. Ordway irrevocably transferred assets to the trustees of the Ordway trust and Mrs. Irvine's interest was created. Moreover, fifteen years later when the Gift Tax Act of 1932 was enacted, Congress expressed its intention not to apply the tax retroactively. Section 501(b) of the Act states: "The tax shall not apply to a transfer made on or before the date of enactment of this Act [June 6, 1932]." Revenue Act of 1932 § 501(b), 47 Stat. 169, 245. This prohibition against retroactive application of the tax to pre-Act gifts has been continued throughout revisions of the Gift Tax Act and is reflected in the current Code in the section governing computation of the tax. 26 U.S.C. § 2502 (1988) (the tax is computed upon the aggregate sum of taxable gifts made throughout the donor's life during periods following

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[1] The issue of timeliness is the subject of *Jewett v. Commissioner*, 455 U.S. 305 (1982). *Jewett* deals with the timeliness of the disclaimer of an interest created *after* the effective date of the federal gift tax and thus does not speak to the precise issue we confront here. It was beyond dispute in *Jewett* that the transfer creating an interest in the person disclaiming was a taxable transfer.

June 6, 1932). "Congress has been careful to avoid any taint of retroactivity in connection with the 1932 [gift] tax and the subsequent amendments to the tax." C. Lowndes, R. Kramer, J. McCord, *Federal Estate and Gift Taxes*, 643 (3d ed. 1974).

However, where Congress has feared to tread the Eleventh Circuit has rushed in with its stunning determination that "the 1917 gift [of Lucius P. Ordway] was a taxable transfer." *Ordway v. United States*, 908 F.2d 890, 895 (11th Cir. 1990), *petition for cert. filed*, No. 90-1503 (Mar. 27, 1991). The *Ordway* decision gives a new definition to the term "taxable transfer" by referring to section 25.2518-2(c)(3) of the regulations, which provides that "[w]ith respect to inter vivos transfers, a taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift." Treas. Reg. § 25.2518-2(c)(3). Based on that language, the *Ordway* decision concludes that "a taxable transfer occurs whenever there happens 'any transaction in which an interest in property is gratuitously passed or conferred upon another,' 26 C.F.R. § 25.2511(c)(1) [sic], even if that transaction was not subject to the gift tax." 908 F.2d at 895.

The opinion of the Court in the case before us agrees with the *Ordway* court's interpretation of Treasury Regulation § 25.2518-2(c)(3) and holds, *ante* at 7, that "the term 'taxable transfer' in Treasury Regulation § 25.2511-1(c)(2) can refer to a transfer made before the enactment of the gift tax." I cannot accept that startling conclusion. The Court's reliance on a single sentence from a regulation explicating a section of the Code that is clearly inapplicable to the facts here[2] is inappropriate

[2] Mrs. Irvine's disclaimer clearly is not governed by section 2518 of the Code. The interest she disclaims was created by a transfer in the year 1917. Section 2518 applies only to the disclaimer of interests created by taxable transfers made after December 31, 1976. Treas. Reg. § 25.2518-1(a)(1).

and misplaced. Moreover, the sentence is taken out of context to support an expanded and illogical definition of the term "taxable transfer" to include a pre-Act transfer. This distorted interpretation is evident when the sentence is read in context with the sentence that immediately follows it: "[A] taxable transfer occurs when there is a completed gift for Federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift. Thus, gifts qualifying for the gift tax annual exclusion under section 2503(b) are regarded as taxable transfers. . . ." Treas. Reg. 25.2518-2(c)(3). Clearly, the sentence upon which the Eleventh Circuit and now our Court mistakenly rely is concerned with the $10,000 annual exclusion on gifts and has absolutely nothing to do with pre-Act transfers. There is a definitive difference between a taxable transfer that qualifies for the annual exclusion and on which a gift tax therefore is not imposed, such as an annual $10,000 check to a favorite nephew, and a transfer as to which the gift tax is not even applicable, such as a transfer pursuant to an obligation created in an antenuptial agreement executed in 1931 between a man and woman married later that year. *See Commissioner v. Copley's Estate*, 194 F.2d 364, 367 (7th Cir. 1952) (holding that transfers made in 1936 and 1944 pursuant to the 1931 agreement were not taxable because "[t]o hold, as the Commissioner would have us do . . . would require a retroactive application of [the gift tax], which we think is not permissible. See Sec. 501(b) of the Revenue Act of 1932."). The creation of the Ordway trust in 1917 falls into the same category as the transfers pursuant to the 1931 antenuptial agreement in *Copley's Estate*; it is a transfer as to which the federal gift tax is inapplicable—and even more cleanly and clearly so than the post-1932 transfers pursuant to the 1931 agreement in *Copley's Estate*.

In light of the consistently expressed intent of Congress not to apply the gift tax retroactively to transfers made prior to June 6, 1932, I cannot join in the Court's holding

that "the term 'taxable transfer' in Treasury Regulation § 25.2511-1(c)(2) can refer to a transfer made before the enactment of the gift tax." *Ante* at 7. Logic, history,[3] the expressed intent of Congress, and a straightforward reading of the regulations all join here to compel the opposite conclusion. Because the contingent remainder interest that Mrs. Irvine disclaimed in 1979 was created in 1917, it never was subject to the federal gift tax and therefore was never a "taxable transfer" for federal gift tax purposes. Once the pretense that by some mysterious alchemy the treasury regulations have transformed the non-taxable 1917 transfer into a taxable event is stripped away, the government is left without any authority (other than *Ordway*, which cannot withstand critical analysis) to support its position.

As the federal gift tax simply does not apply here, I forego discussion of the issues concerning the timeliness of the disclaimer and the retroactive application of *Jewett*. If the gift tax is inapplicable, as I believe it plainly is, then these are non-issues.

For the reasons stated, I would affirm the decision of the District Court in favor of the taxpayers.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit.

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[3] The Supreme Court struck down, on Due Process grounds, the original federal gift tax (enacted in 1924) to the extent it attempted to tax transfers made prior to its effective date. *See Blodgett v. Holden*, 275 U.S. 142 (1927).